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Chairman, Financial Reporting Council
Investor Forum Annual Review – Keynote speech
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Thank you, Simon and thanks Andy, and thank you for the opportunity to join your annual review meeting this evening with such an august guest list.

Well-functioning markets are essential for all of us and underpin the attractiveness of the UK as a place to do business. When markets work well, they provide cost effective capital for businesses to grow as well as appropriate scrutiny to make sure that companies not only deliver for their shareholders but also play their part in society. By this I mean taking account of how they impact other stakeholders including employees, customers, suppliers, pensioners and how they impact their environment and local communities. This wider perspective should not be at the expense, however, of building successful businesses. nstead it should be seen as a vital foundation for building sustainable and long-term success.

We all have a role to play in supporting the development of efficient and well-functioning markets. In particular, it requires active and sustained engagement from all of you. You should be engaging with the companies you invest in as well as with each other to address both specific and systemic issues promptly as they arise. The FRC is very supportive of the work that The Investor Forum has been doing over the last five years to facilitate and encourage this sort collaboration. We hope to see a lot more of it in the future.

The FRC is also looking hard at its own role in supporting well-functioning markets. We regard this as central to our mission. The high standards we set for company accounting, reporting and auditing help provide the information that the market needs.

I accept though that, in the past, the FRC has not always been as quick as it should have been in recognising the impact of shortfalls in auditing, reporting or governance standards. We have been slow to realise the broader impact that these failings can have – impacting not only shareholders but also many other stakeholders as well. We need to see those connections more clearly and quickly and be prepared to act on them – but we also expect investors to be doing the same, as set out in the new Stewardship Code that we published late last year.

The recent updates to the Corporate Governance and Stewardship Codes aim to set much clearer expectations for how companies in the market ought to be run and how investors in those companies should play their part as responsible and active owners.

The new UK Stewardship Code was the product of a wide ranging and fundamental review over the last two years that helped us to design a new framework for Stewardship in the UK. Thank you to those of you in the room this evening who played an important part in developing these new proposals.

We want the new Code to support a significant step up in the standards of stewardship across the market. While many asset managers and investors <u>are</u> active and engaged, unfortunately too many are not. We do not believe this is serving clients well or providing sufficient protection for the interests of savers and pensioners.

The 2020 Code lays out a new definition of stewardship. It establishes clear expectations that stewardship is about the responsible allocation, management and oversight of capital to create long term value for clients and beneficiaries. Excellent and effective stewardship is key to well-functioning markets and ultimately will also support the attractiveness of the UK as a place to invest.

One of the most fundamental changes in the 2020 Code is the move away from policy reporting to a focus on the reporting of stewardship activities and the outcomes achieved by signatories. What does this really mean? Well, it is no longer enough to talk a good game, we want Stewardship Code signatories to demonstrate to their clients that they play a good game as well.

This clear reporting is part of how the Code aims to differentiate excellence and encourage demand for excellent stewardship from asset owners and beneficiaries through clear and consistent reporting.

As an example, activity reporting should include a description of the nature of the collaboration undertaken to hold companies to account, as well as to contribute to well-functioning financial markets. We need signatories to do more, to work together when appropriate and to demonstrate that they are taking their responsibilities as owners seriously. We would also like to see you highlight collective concerns on market issues to us at the FRC. This will help us target our monitoring activity more effectively.

The Investor Forum Annual Review has some great examples of effective stewardship in action. One that caught my eye is the work done with First Group which demonstrates how collaboration can work well. This is just one example - but shows how the collective voice provided a clear message on the urgent need for change. It provided clarity on the range of concerns and amplified the call for action. It is encouraging to see the changes that can happen as a result of this type of engagement.

Another important change in the new Code is the stronger emphasis we are placing on ESG issues. The Code now asks signatories to explain how they integrate material ESG factors, including climate change, into their investment processes. This is really important issue and one that cuts across a lot of the FRC's work. I am pleased to see the focus on ESG issues in the Investor Forum Annual Review.

We understand that investors also need high quality reporting from companies on these issues. We are reviewing the reporting requirements and the role audit or assurance could play around this type of information, particularly in the context of the recent recommendations from the Brydon Report. With COP26 being held later this year in Glasgow, I am sure that the attention on this area will only increase. However, we also need to try and develop some consistency in reporting requirements if the many disclosures being asked for are to be useful.

I have taken over the Chair of the FRC at an exciting time. The series of independent reviews into the audit market, the role and scope of audit and the best way to regulate audit, reporting and governance offer the possibility to create a very different regulator for the future. One that is setting the agenda. One that is proactive in driving improvements in the quality of corporate reporting and audits. And one with teeth that it is not afraid to use when those it regulates fall short of the highest standards. Delivering this vision will require a carefully coordinated and linked programme of reforms and legislative changes. We are working hard with government to get this in place and pushing for it to be implemented as quickly as possible to reduce the risk and impact of future failures and build the foundations of sustainable improvements in audit, governance and reporting standards.

Given this urgency, the FRC is not standing still while we wait for the necessary legislation we have already implemented a number of changes. By the end of 2019, we had actioned 20 of the 83 recommendations in Kingman. I am also in the middle of a significant review of the shape and governance of the FRC to speed up our decision making and ensure we have the right skills available at both board and executive level.

We are considering ways to reform the structure of the audit profession, including detailed thinking on models of operational separation. We are looking at how shared audits could be encouraged to build the capabilities and capacity of the challengers to the Big 4 and bring more choice into the market. We believe this sort of managed approach would be a more practical and effective way to enhance competition than the introduction of joint audits which seem a step beyond the challengers' capabilities at this stage. We are also looking at whether a controls framework in the UK similar to the Sarbanes-Oxley regime in the US would make sense. All of these issues are part of supporting well functioning markets.

We want to help audit committees to be better able to understand and assess audit quality, so we are expanding our programme of inspections and planning to publish more of the results of our individual audit reviews. And of course, we will continue our work in setting and monitoring codes and standards. Above all, we will ensure that everything we do retains a sharp focus on promoting and improving the quality of reporting and audit in the UK.

We will do more, but my ask is for all of you to do more as well. Better standards and better outcomes require all of us to play our part. I wonder how many of you have met an audit committee chair in the last year? Or more importantly, how many have spent significant time with an audit committee chair? That is exactly the sort of specific activity that we want to see in the new Stewardship reports.

We should remember that the UK has a proud history as a leader in the development of modern corporate governance. The UK Corporate Governance Code has evolved over 27 years, and throughout that time has been a model that has led around the world.

We recently issued a report looking at the reporting done by 'early adopters' of the revised Corporate Governance Code from the FTSE100. The new Code raised the bar considerably and has led to some high-quality reporting, but we still found that greater focus is needed on longer-term sustainability issues including stakeholder engagement, diversity and the importance of culture.

One of the strengths of our corporate governance framework is the flexible nature of the Code. While premium listed companies are required to apply the Principles of the Code, the detailed Provisions are to be followed on a 'comply or explain' basis. This flexibility is critical. It is part of what makes the UK such an attractive market to list in.

We want to see high quality governance, and we believe that the Code sets out a clear set of best practices, but we also understand that in some cases there are important and valid reasons for companies to depart from these provisions.

We observed in our recent governance review that, in a number of cases, companies seem to feel pressured to be box tickers, to apply the Provisions of the Code as though they are a rule book. This is not the intention and undermines a key part of the UK's attractiveness as a market.

This is where the link between the two Codes becomes critical. Your role as investors and stewards is to engage with companies to understand those instances where a variation might be justified and support companies to use the flexibility the Code provides if appropriate for the long term success of the business However, in those circumstances, I would also like to see you pushing companies to provide better explanations in these sorts of situations.

So, we need investors to move away from box ticking as well. You should not allow the responsibilities of Stewardship to be delegated to service providers. We need you to think about the information and advice you get from them and to assess whether they are meeting your needs as they support your stewardship activities.

It is not enough to just set a voting policy. This is particularly important where there is a contentious issue. Leaders of larger investors, whether independently or through bodies such as the Investor Forum, when they think it is appropriate, can offer a more flexible approach to companies trying to navigate difficult situations, even when the proxy advisors are adopting a more rigid approach.

This is probably not going to be something that happens very frequently, but it is an important part of the UK governance framework, I believe it is an important part of what makes the UK an attractive and well-functioning market and I believe it's an important thing to protect.

In my view the system of high standards and flexible codes we have in the UK does support a well-functioning market. But we can do more to ensure that it stays that way in the future. In particular, we all need to work together to continue to build a better system, to promote a focus on judgement and not just box ticking and to help create long term value for the benefit of society as a whole.

Thank you