NEST’s Response to Sir John Kingman’s Independent Review of the Financial Reporting Council

Introduction

NEST is pleased to have the opportunity to respond to the Independent Review of the Financial Reporting Council (FRC).

NEST is a defined contribution (DC) pension scheme that UK employers can use to meet the workplace pension duties set out in the Pensions Act 2008. NEST is designed to be an easy-to-use, low-charge scheme. It has a public service obligation to accept employers of any size that want to use it to comply with their duties.

NEST Corporation is the Trustee body that runs NEST. The Trustee Members set NEST’s strategic direction and objectives. Their duties are the fiduciary duties of any trustee. These include acting in the interests of the members whose money it holds in trust, and to abide by the regulatory framework the scheme exists within.

At the time of writing NEST is working with over 600,000 employers, over seven million members and over £3.2 billion in assets under management. A key aim of the scheme is to provide members the benefits of a good value, quality occupational pension scheme, whoever their employer and however much they save.

NEST invests and owns stakes in thousands of companies globally and is likely to be among the very largest institutional asset owners in Europe in the near future. How these companies are governed, regulated, and run is a concern of the members of NEST as it will be a determinant of the performance of NEST’s funds and of members’ incomes in retirement.

While NEST is international in its capital allocation, we are a UK registered pension scheme with a membership comprised of workers who are making contributions from UK earnings, giving us a major interest in the performance of the UK capital market.

Summary

A large body of empirical evidence finds greater size of capital markets and relatively better investor trust and confidence where there are institutions that support high corporate governance standards, reliable financial reporting from companies, and high quality statutory audits[1].

Effective governance, reporting, and audit standards allow investors to make well-informed investment decisions and help to guide the stewardship activities that pension funds like us carry out on behalf of our members. In the absence of that stewardship there is little to bind listed companies to the Corporate Governance Code.

We are aligned with the UK Government in desiring the broad goals of long-term investment in the UK economy, a high-quality UK capital market, and the attractiveness of the UK as a place for companies to publicly list. We believe that one foundation stone to help achieve those goals is effective corporate governance, financial reporting and audit practices.

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[1] See, for example, work by La Porta

In order to support appropriate market structure and conduct, an independent regulatory body is needed with a remit of setting and supporting corporate governance, investment stewardship, financial reporting and audit standards. That current role is performed by the FRC. We see no reason for the role or the provider to change.

Confidence and trust are paramount if the FRC is to continue to set and maintain standards in the overlapping areas of corporate governance, investment stewardship, financial reporting, and audit. We believe strongly that stakeholder representation is key to the attainment of that. We would support improved representation of key, long-term, investor stakeholders and responsiveness to their perspectives.

Long-term returns to shareholders are the key objective of the company while mindful of wider considerations. That makes long-term shareholders the principal investor stakeholder of the Corporate Governance Code. The further that investors look ahead the more important wider attributes become. Going concern over the next 12 months is at the short end of our time horizon yet the FRC is highly focused on that timeframe, to line-up with the concept of going concern of one-year as stipulated by generally accepted auditing standards (GAAS). Greater focus on a longer time horizon is in our view crucial to the FRC's future performance as a regulator. Conversations about areas of wider assurance, including non-GAAP financial performance and broader contextual considerations such as culture, conduct, quality, human capital, climate, and the environment, have not been given the focus that we as long-term investors feel they deserve. For that reason, we've been disappointed that the FRC's promising early work on viability was not followed through in the way many long-term investors would have liked.

Setting actuarial standards does not overlap in quite the same ways as do audit, corporate and financial reporting, corporate governance, and investment stewardship. Accordingly, setting actuarial standards could move to another body.

Having reflected on NEST's interactions with the FRC over the last eight years, we suggest that the Review give serious consideration to what are the most important aspects of the FRC's work, which aspects should be retained, and which should be passed to other bodies, and where there may be skills gaps, for example deep investment knowledge and investor relations.

Below we summarised the key strengths and weaknesses of the FRC as we see them.

Strengths and weaknesses

Continued development of corporate governance has made the Corporate Governance Code a beacon of international excellence. The Stewardship Code has started well and has similar 'beacon' potential, but to fulfil that it now needs to be appropriately updated and firmly linked to the Corporate Governance Code.

Good work is undertaken by the Corporate Reporting Review (CRR) and Audit Quality Review (AQR). Both have helped to improve audit and reporting quality in the UK. Larger sample size and an additional deliberative risk-based subset within the stratified sample would help to improve the confidence with which users interpret the findings.

Within the FRC's governance structure, the committees and councils comprising non-executive members bring essential stakeholder accountability. The remit of these committees are often overly narrow, and we believe the FRC would benefit from not immediately dismissing the wider perspectives often raised at meetings.

The Financial Reporting Lab has helped to facilitate investor-company engagement in a non-confrontational, constructive environment. Over many years the Lab has been useful in considering different ways in which reporting can be improved. The Lab is internationally recognised, but in terms of our needs we would suggest it focuses too much on corporate reporting to aid short-term price discovery. We think this leads to insufficient attention being paid to corporate reporting that would improve understanding of the drivers of long-term value. Economic history tells us that price and value are not the same. As a concrete example, the recent Financial Reporting Lab report on disclosures held up Carillion's dividend disclosures as an example of best practice while longer-term structural and cultural problems affecting value and viability

went unidentified. The FRC's Lab partnered with NEST and other long-term investors on a roundtable about reporting workforce and human capital metrics, but then failed to follow-up as intended on the way such reporting can support discovery of long-term value.

The FRC has a good reputation for starting fresh debates, including work on viability statements, corporate culture, board effectiveness reviews and auditor tendering and rotation – however, an argument could be made that having put ideas out there, tested the idea with stakeholders, and received comment, that subsequently there is insufficient follow through on the conclusions and findings.

Concerning the split between international and domestic focus, rightly or wrongly, the FRC has decided that global standards are what matters, be it in accounting or audit, and believes it's vital for the FRC to be able to influence the development of those standards. It does so by very active participation on international standards boards, responding to consultations, and by the UK acting as a pathfinder in strategic areas like reporting. The agenda is very much about convergence. The FRC invests the resource to make the global standard as good as it can be, so the only additions made to UK standards are those that are needed to reflect the UK legal and regulatory context, and not because a standard is fundamentally flawed.

London is arguably the second largest capital base in the world, and that position would tend to justify the international approach adopted by the FRC. Global audit firms as well as global investors use and want global standards. However, some international standards boards are not well resourced. In making available whatever time and resource is necessary to provide the support needed, the FRC may risk reducing focus within the UK.

The FRC may well have alighted on the right allocation of resource, but less allocation of resource to pursuing national interests and issues may in part explain the 'bad press' that sometimes follows the FRC. In short, the FRC is a respected international contributor but on the domestic front, perhaps less so. We hope the Review will consider the suitability of that resource allocation.

We do find the FRC's current mission statement 'to promote transparency and integrity in business' too vague. The FRC recently amended its mission statement and in doing so dropped all references to fostering investment. In our view the FRC should re-establish the link between the FRC's mission and supporting long-term, sustained investment in the UK. Objectives would then benefit from refreshment in line with the mission, and there is a case to be made that the FRC's objectives be set in law with accountability to BEIS, similar to the FCA's accountability to HM Treasury. At present there is a memorandum of understanding. Not all activities, for example setting actuarial standards, appear to be core to the FRC's work, to meeting the objectives, or the overall mission. Consideration should be given to taking these across to another body. Doing so should help the FRC to achieve greater focus.

There is a great diversity of investors. The FRC has been successful at speaking to one type but has poorly networked with other investor types. Pension funds that outsource their asset management, endowment, charity, church, wealth, and retail investors are notably under represented. The formation of the Investor Advisory Group is a positive, but its representation is narrow and again mostly focused on one type of investor. The Review should consider how this can be redressed, including any skills or resource gaps that may be responsible for this. Many of those under represented have the long-term investment horizons and patient capital sought by Government. Without more effective promotion of that investor voice, the FRC is unlikely to achieve the successful investment stewardship outcome we all seek. The FRC's information sessions for investors amplify an arms-length and remote approach.

Our experience is that too few staff have a deep understanding of investment, and there has been unhelpfully high staff turnover in investment and financial reporting Lab roles.

The FRC has often been shy of picking-up the theme of conduct, of entering into key debates with those it regulates. Unblocking these channels is, we believe, key to delivering successful outcomes for long-term investors and capital markets. For that to happen corporate culture has to be addressed. One conduct example, in the audit area, is the imbalance of diversity among FTSE 100 and 350 audit committee chairs and audit partners. See tables below. A result is the limited audit committee candidate choice this provides PLCs. The FRC has done little to address this or similar conduct risks raised repeatedly by investors. The above is an example, we believe, of a direction by the FRC that involves too narrow an interpretation of its remit and some reluctance to address the subjective nature of any audit process.

Index	No of Audit Committee Chairs (Female)	% of Female per Index
FTSE 100	14	14.00%
FTSE 350	57	16.29%

Index	No of Audit Engagement Partners (Female)	% of Female per Index
FTSE 100	0	0.00%
FTSE 350	3	0.86%

Note: as at 05th April 2017. Source: Manifest and NEST.

On the audit side, the constructive engagement with audit firms available to the FRC in less significant investigative cases where there is not demonstrable misconduct or failure does not seem as strong a stick as may at times be needed to influence large audit firms. In addition, currently, financial sanctions or penalties are currently only possible through the formal Enforcement Procedure. We would like to see the FRC being granted greater audit firm related sanctioning and disciplining powers.

The FRC has no power to challenge the front end of the annual report, including corporate governance statements. We believe this should be addressed by extending the scope of corporate reporting review powers, combined with a power to undertake or commission a report into, for example, the quality of governance, risk, and viability reporting akin to the powers of the FCA.

The FRC does not make public the outcomes of the Corporate Reporting Reviews (CRR) and Audit Quality Reviews (AQR) into individual companies. Not doing so means that investors cannot understand some of the FRC's findings and concerns. If the FRC did make outcomes public, investors would be able to use this information in their engagement with companies and when making investment decisions.

Where the FRC has developed a concern over the financial statements it does not have the power to investigate and discipline Directors that are not members of an accounting body. As all Directors sign off the Report and Accounts it seems to us that all Directors should be held accountable under the FRC's Accountancy Scheme for the preparation of the accounts. We believe the monitoring regime should be extended to cover all Directors.

The FRC has to varying degrees failed to fully follow-up on initiatives to ensure they achieve real change, such as viability statements, culture, and Board effectiveness reporting. In addition, the FRC has been reluctant to engage in work on the potential value of wider assurance, or of challenging whether the

statutory audit is now too narrow an instrument for long-term investors. Conduct, culture, quality, reputation, human capital, climate, and environment become key sources of investment risk over longer investment horizons. We would like to see the FRC take-up the conversation about the adequacy of the current audit regime and how and where wider assurance could and should fit within.

Our understanding is that the FRC eventually investigates failure after fraud and insolvency experts have done their part, however of more value to investors would be if the FRC signalled concerns before problem companies become terminal. We believe that doing so passes a public interest test. There would be great potential value if the FRC was to warn investors when it comes across issues in reviewing audits of companies that appear to be in danger, that there are warning signs that companies might be beginning to fail. Zero corporate failure is not possible, and perhaps not desirable, but flagging early warning signs is key so that investors can follow through. Exit interviews with Directors, with outgoing auditors, information sharing with UKLA, the PRA, surveys of Alumni, and intelligence from audit review could be consolidated and early detection flagged. Investors acting on those early warning signs is the essence of good governance and investment stewardship.

Below we provide further feedback to individual consultation questions.

Our response to the Review's questions

FRC purpose and function

Q1: What should the FRC's objective(s) be? Is its present mission statement the right one?

We believe the right approach is an independent regulatory body with a similar remit to the FRC. We support the FRC performing this role.

Over time, as the FRC's remit has expanded, so has the mission statement. It may now lack the depth needed to provide appropriate organisational purpose. A clear central purpose and mission is now needed in order to motivate the right internal culture. The mission statement needs to re-connect to long-term, sustained investment in the UK, which is the desired outcome. Objectives should be refreshed to help the organisation focus resources and effort on producing outcomes that support the mission and purpose. High quality corporate governance, investment stewardship, corporate reporting, and audit help achieve those outcomes.

Q2: Does the FRC's name remain right?

Our view is that this does not need to change. Internationally the FRC is well-known, influential, and held in high regard.

Q3: Are the functions and structure of the FRC still relevant and appropriate, or is there a case for any structural change? Should any of the FRC's functions move to other regulators?

We support the FRC having a wide scope over corporate governance, investment stewardship, financial reporting, and audit. A wide scope helps to provide the capacity to take-on the foreseeable and the unforeseeable that potentially may be needed to maintain a strong reporting and governance regime. A wide scope can also make the space needed for innovation. An example of the latter is the Stewardship Code. We hope that by providing a wide scope the FRC will find the comfort and justification to pick-up on investor requests, such as consideration of wider assurance and the future appropriateness of the current audit regime.

Q5: How effective has the FRC been in influencing wider debates that affect its ability to deliver its objectives – for example, around audit competition, or its legal powers?

The FRC appears to have been continentally and globally influential on areas of corporate governance, investment stewardship, reporting and audit. The FRC has helped to start a number of wider debates, including viability statements, corporate culture, board effectiveness reviews and auditor tendering and rotation. In the UK, the follow-through on these has been weaker.

Impact and effectiveness

Q7: What are the FRC's strengths and weaknesses?

- The Corporate Governance Code is a beacon of international excellence.
- The Stewardship Code has started well but it now needs to be appropriately updated.
- Good work is undertaken by the Corporate Reporting Review (CRR) and Audit Quality Review (AQR). Sample sizes need to grow.
- Within the FRC's governance structure, the committees and councils comprising non-executive members bring essential stakeholder accountability, but the wider perspectives often raised at meetings are dismissed as out-of-scope rather than captured and reintroduced elsewhere.
- The Financial Reporting Lab is internationally recognised, but insufficient attention is paid to corporate reporting that would improve understanding of the drivers of long-term value.
- The FRC has a good reputation for starting fresh debates but there has been insufficient follow through on the conclusions and findings.
- The FRC's current mission statement is too vague.
- The FRC has been successful at speaking to one type of investor but has poorly networked with other investor types. Pension funds that outsource their asset management, endowment, charity, church, wealth, and retail investors are notably underrepresented. The formation of the Investor Advisory Group is a positive, but its representation is narrow and again mostly focused on one type of investor.
- Too few staff have a deep understanding of investment, and there has been unhelpfully high staff turnover in investment and financial reporting Lab roles.
- The FRC has often been shy of picking-up the theme of conduct, of entering into key debates with those it regulates. Unblocking these channels is key to delivering successful outcomes for long-term investors and capital markets. For that to happen corporate culture has to be addressed.
- The FRC has no power to challenge the front end of the annual report, including corporate governance statements.
- The FRC does not make public the outcomes of the Corporate Reporting Reviews (CRR) and Audit Quality Reviews (AQR) into individual companies. Not doing so means that investors cannot understand some of the FRC's findings and concerns.
- Where the FRC has developed a concern over the financial statements it does not have the power to investigate and discipline Directors that are not members of an accounting body.

- The FRC has, to varying degrees, failed to fully follow-up on initiatives to ensure they achieve real change, such as viability statements, culture, and Board effectiveness reporting.
- The FRC has been reluctant to engage in work on the potential value of wider assurance, or of challenging whether the statutory audit is now too narrow an instrument for long-term investors. The lower the quality of information about the long-term the more unclear we are about the ability for a company to sustain its performance and the less easy it is to take that patient investment perspective desired by Government.

Q8: The recent joint report on Carillion from the Business, Energy and Industrial Strategy and the Work and Pensions Select Committees considered the FRC to be characterised by 'feebleness and timidity' and recommended that a change of culture and outlook is needed. Do you agree? If so, please cite relevant evidence which informs your view.

Our opinion is formed from many interactions with the FRC on financial reporting, audit, investment stewardship, corporate governance, human capital, climate metrics, and impact analysis. Overall, and particularly in recent years, we've if anything evidenced a defensive culture. Channels that once led to action appear to have become blocked. We are not seeing activity turn into constructive action. Too often activity appears to be directed at justifying little or no action. Unblocking these channels is, we believe, key to delivering successful outcomes for long-term investors and capital markets. For that to happen corporate culture has to be addressed.

We've not evidenced 'feebleness and timidity' but understand how this view may be formed from the Carillion case. Our understanding is that the FRC is only able to investigate after prior due diligence and work by others such as fraud and insolvency teams.

Capitalism relies on the possibility of failure and so the FRC cannot be expected to prevent corporate failure. The backward-looking lens of audit is unable to prevent the failure of every problem company. Rather than remain silent, however, there is merit in flagging risks early, where they are known, so that a positive outcome remains a potential possibility via investment stewardship. There is scope for the FRC to take on an early concern role that investors can then take forward into their stewardship.

Q10: Are arrangements for financial reporting, audit and corporate governance the critical elements for effective delivery of FRC's mission, or are elements missing?

The elements mentioned in the question are key, but so too is investment stewardship. The review of the Stewardship Code and implementation of the EU Shareholder Rights Directive both create an opportunity to consider the best way to focus and make revisions to the Stewardship Code. We hope a common thread will run from the FRC's Stewardship Code to the FCA's intended approach towards stewardship activities of regulated firms.

We should remain mindful that there is not wide agreement of what stewardship is, and is a term not recognised in the US, so the construct may not gain the wide acceptance that corporate governance has achieved.

The key missing element is time frame. The lower the quality of information about the long-term the more unclear we are about the ability for a company to sustain its performance and the less easy it is to take that patient investment perspective desired by Government. In addition, the further that investors look ahead the more important wider attributes become. Going concern over the next 12 months is at the short end of our time horizon yet the FRC is highly focused on that timeframe, to line-up with the concept of going concern of one-year as stipulated by generally accepted auditing standards (GAAS). Greater focus on a longer time horizon is in our view crucial to the FRC's future performance as a regulator. Conversations about areas of wider assurance, including non-GAAP financial performance and broader contextual

considerations such as culture, conduct, quality, human capital, climate, and the environment, have not been given the focus that we as long-term investors feel they deserve.

Audit regulation

Q11: How effective is the FRC at driving quality improvements in audit? What further improvements would respondents like to see?

We'd support increasing the number of AQRs, via purposeful risk-based sampling, as well as by increasing the stratified sample size, in order to increase the reliability of the results. We'd also support fuller publication of outcomes. The AQR has been effective at getting audit firms to pay close attention to quality.

Evidence suggests that the FRC's and EU's work on audit tendering and rotation has, post implementation, improved neither statutory audit quality or value for money. There needs to be more focus on the performance of the industry, as opposed to its market structure alone.

We would be supportive of the FRC taking on a leadership role around the future of audit and wider assurance. We believe there is significant scope to improve quality by responding constructively to changing needs and expectations.

Q12: Where quality does fall short, do the FRC's interventions have sufficient impact and deterrent effect?

Interventions appear to lack impact. The size of fines levied that we know about seem inappropriate, and low, but also non-financial sanctions can be important. The FCA has had some good success with non-financial sanctions and that some of those ideas may be able to be taken across the FRC.

Q13: What force is there in the concern of some that the FRC may be too close to the 'big 4'? Or that the FRC is too concerned with the risk of failure of one of the 'big 4'?

The PRA and the CMA would be most worried about the risk of failure of one of the 'big 4'. The audited numbers feed directly into the capital framework monitored by the PRA and in particular the large lenders. One less accountancy and audit firm would have significant consequences for the number of audit tender responses PLCs would receive. That would concern the CMA. We've not sensed that the FRC is unduly worried.

The FRC's Board is heavily represented by Directors with audit backgrounds, and our understanding is that the predominant private sector background of FRC staff is the largest accounting and audit firms. The other main background is the public sector. We note that some high-profile change has recently been made to address insufficient independence from the large audit and accounting firms.

The FRC should feel the same winds of change as corporate boards and look to establish a diversity of perspectives and stakeholders to reduce group think and in particular 'big 4' thinking. The committee structure of non-executive members is one way the FRC does hear diverse views and reduce group think. However, such views are too rarely acted on.

Q14: Are investigations of audit work effective, transparent, satisfactorily concluded and unfettered?

It is difficult for us as investors to judge this, however fuller disclosure of AQR results would be helpful.

Q17: Can questions regarding the effectiveness of the FRC be separated from the wider question on whether change is needed to audit arrangements to take account of shifting expectations?

These are interlinked, but yes. There is a need to discuss the future of audit and whether it's serving the needs of investors and other users of annual reports, and that debate can be undertaken with or without the regulator. For example, the time frame, the reporting, the front-end of the annual report, clarifying auditor accountability.

Accounting and Financial Reporting

Q18: Has the FRC been effective in influencing the development of accounting standards internationally as well as accountable and effective in setting UK GAAP?

Concerning the split between international and domestic focus, rightly or wrongly, the FRC has decided that global standards are what matters, be it in accounting or audit, and believes it's vital for the FRC to be able to influence the development of those standards. It does so by very active participation on international standards boards, responding to consultations, and by the UK acting as a pathfinder in strategic areas like reporting. The agenda is very much about convergence. The FRC invests the resource to make the global standard as good as it can be, so the only additions made to UK standards are those that are needed to reflect the UK legal and regulatory context, and not because a standard is fundamentally flawed.

London is arguably the second largest capital base in the world, and that position would tend to justify the international approach adopted by the FRC. Global audit firms as well as global investors use and want global standards. However, some international standards boards are not well resourced. In making available whatever time and resource is necessary to provide the support needed, the FRC may risk reducing focus within the UK.

The FRC may well have alighted on the right allocation of resource, but less allocation of resource to pursuing national interests and issues may in part explain the 'bad press' that sometimes follows the FRC. In short, the FRC is a respected international contributor but on the domestic front, perhaps less so. We hope the Review will consider the suitability of that resource allocation.

Q19: How else could the FRC improve the quality of financial reporting with a view to ensuring investor confidence?

We've mentioned elsewhere in this response a need to take-on longer-term and wider considerations. The FRC is unnecessarily fixed at the short end of price discovery. The recent going concern project is one case in point. Long-term, patient capital desires an understanding of long-term value, and that is different to price. An appropriate direction for the FRC is in supporting patient capital better understand long-term value.

Q20: Are there wider issues of financial and other reporting on which a stronger regulatory role would be desirable to better meet the information needs of investors and other stakeholders?

Yes, the FRC should have powers to investigate all directors in relation to the preparation and approval of financial reports, rather than just directors who are members of an accountancy body or profession.

The Review might consider having the FRC review the quality of the front-end of reports from companies applying to list on the LSE so that companies cannot simply list in the UK without regard to their governance quality.

Corporate governance and stewardship codes

Q22: In relation to the UK Corporate Governance Code, are there issues relevant to the review's terms of reference that respondents believe the review should consider?

The UK Corporate Governance Code has been the cornerstone of corporate governance in the UK for over 25 years and is internationally held in high regard. One of the Code's strengths has been its successful evolution alongside emerging governance issues and best practice.

There are instances where initiatives carried out through the Corporate Governance Code, such as encouragement of viability statements and a focus on culture, have not been carried to completion.

We continue to hope for more from the FRC on reporting long-term viability and culture.

Q23: How effective has the stewardship code been in driving more and higher quality engagement by institutional investors? If not, why? How might quality of engagement be further strengthened?

The UK is recognised internationally as being a leader on investment stewardship, however as stewardship practice has developed, the Code has failed to change appropriately and now urgently needs to do so in order to remain relevant. The current Stewardship Code focuses on governance issues, investments in equities, the role of asset managers and proxy voting. The Code needs to encompass a much greater range of activities, factors, and topics, while capturing the essence of investment stewardship in a way that is simple, relevant, transparent, applicable and constructive.

We would be delighted to discuss in more detail our views on this.

The Stewardship Code has been adopted by the FCA, but many asset owners are large investors that are not regulated by the FCA so are not required to produce a stewardship statement. We hope the FRC, in collaboration with BEIS and the FCA, might solve this in the forthcoming review of the Stewardship Code.

We look forward to contributing to the 2018 review of the Stewardship Code.

FRC and corporate failure

Q27: Is there more the FRC could or should do to help reduce the risk of major corporate failure?

Better disclosure of CRR and AQR results will help investors hold companies to account. The FRC could signal concerns it has identified before problems become terminal. Early detection of problems would help investors to engage and hopefully prevent some problem companies from failing.

Q28: Is the FRC quick and effective enough to act on warning signs arising from its work on accounts and financial reporting, or on evidence of concerns over poor corporate governance?

No, we believe the FRC should signal concerns before problem companies become terminal. We believe that doing so passes a public interest test. There would be great potential value if the FRC was to warn investors when it comes across issues in reviewing audits of companies that appear to be in danger, that there are warning signs that companies might be beginning to fail. Zero corporate failure is not possible, and perhaps not desirable, but flagging early warning signs is key so that investors can follow through. Exit interviews with Directors, with outgoing auditors, information sharing with UKLA, the PRA, surveys of Alumni, and intelligence from audit review could be consolidated and early detection flagged. Investors acting on those early warning signs is the essence of good governance and investment stewardship.

Q29: Is there a case for a more ‘prudential approach’? If so, how could this operate in practice, and to which category of company might such an approach apply?

The systemically important firms’ regime is for the PRA. The non-systemically important firms could be for the FRC. By pulling intelligence from various existing public sources, for example changing patterns of institutional ownership from UKLA, the FRC will develop some understanding of problem companies and that can be valuable to the FRC and for investors to take into their stewardship.

Q30: Introduction of the viability statement was an important development, but could it be made more effective?

The viability statement was a great initiative, but we’ve subsequently seen the majority of companies providing viability statements for three years rather than a preferred longer term. Many companies now regard their viability statement as just another legal and compliance hurdle to overcome. Other reporting has not centred around justifying the viability statement but if it did that would be very helpful to long-term investors. We had hoped for a longer-term viability and/or corporate reporting that told the story of viability through the directors’ eyes. That narrative would help long-term investors in their understanding of quality, and of determining value in the future versus price today.

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