Association of British Insurers

BIS Consultation – The Future of Narrative Reporting

Introduction

The ABI is the voice of the insurance and investment industry. Its members constitute over 90 per cent of the insurance market in the UK and 20 per cent across the EU. They control assets equivalent to a quarter of the UK's capital. They are the risk managers of the UK's economy and society. Through the ABI their voice is heard in Government and in public debate on insurance, savings, and investment matters. As a representative of major institutional investors we welcome the opportunity to respond to this consultation.

Executive Summary

ABI members are supportive of high quality narrative reporting with a focus on strategy and significant risks and uncertainties, underpinned by the principle of materiality.

Narrative reporting has a key role in helping investors understand the businesses concerned and its long-term future. The value of a good narrative report can be seen in many areas. Its beneficial impacts include: helping create constructive relations between shareholders and the companies they own; imposing a discipline that contributes to management's clarity of thought when developing a company's strategy and business model; focusing attention on non-financial aspects on corporate reporting, including social and environmental factors; helping to bring a forward looking aspect to the annual report; and having an underpinning role to the share price that encourages long-term investment in the interests of the economy as a whole.

ABI members are both significant institutional investors and major issuers of reports in their capacity as publicly listed companies. Narrative reporting is a tool for communication between companies and shareholders. And it these two parties that should be primarily considered when seeking to determine what steps should be taken to improve narrative reporting or reform its framework.

It should be recognised that in terms of current standards the level of reporting in the UK is world-class. Although we recognise that there are issue around boilerplating, and some companies not providing meaningful reporting, we do not believe that there is a need for a radical overhaul of the current framework. We consider that any move to increase the volume or

prescription in reporting, will merely lead to more boilerplating and a box-ticking approach.

The ABI supported the concept of Operating and Financial Review before it was repealed and do not object to its reintroduction in principle. However, we have some concerns in relation to the role of the statutory auditor. There are a variety of views on the role of the auditor in relation to assurance of narrative reporting and considerable concerns that this will merely increase the fees paid to auditors with no corresponding benefits. We believe that more thought needs to be given to how an appropriate framework can be constructed.

We do not favour an advisory vote on the Business Review. Although we are in favour of proper accountability to shareholders, we consider that the current general meeting structures provides opportunities for this, and that there is considerable potential for confusion in relation to what the exact role and meaning of an advisory vote would be.

We believe that there is value in various non-regulatory initiatives to improve narrative reporting, including awards recognising market best practice and improvements in reporting. We welcome the Government's existing recognition and support of these efforts.

In relation to remuneration reporting, we consider that companies should set out a clear remuneration policy that is linked to its business strategy and is not focused on the boilerplate statement of "attract, retain and motivate". We also believe that the policy should take sufficient account of risk and that reporting should also have more of an outcome focus.

ANNEX

Consultation Questions

Value of Narrative Reporting

1. *Are company directors providing useful and relevant information on the company's:*

   i) forward-looking strategy and
   ii) principal risks and uncertainties?

   It should be recognised that the standard of corporate reporting in the UK is generally world-class, reflecting a long-standing commitment by companies, regulators and investors to promoting transparency in this

area. However, it is also true that the standard of reporting can vary considerably amongst companies. At its best, UK corporate reporting provides clear insights into strategy and the principal risks and uncertainties. At its worst, reporting is boilerplate and barely meets the legal requirements. The reasons for this are also varied. The quality of reporting may be affected by issues such as the nature of the business, the complexities of the activities and organisation, the resources that the company is able to devote to producing the report and the level of interest by investors and others in the reporting. These differences create difficulties when considering how the standards of reports can be raised. In particular, we do not believe that extra requirements, more prescription or standardisation would lead those companies that do not currently report meaningful information to do so. Rather, there would be more boilerplating and an increased tick-box mentality.

2. *What are the constraints on companies providing information on these issues?*

   There remains concern within the corporate community regarding issues around commercial sensitive and liability. However, we do not consider that these concerns should unduly restrict meaningful disclosure. Over time, as market best practice continues to develop we believe that there should be improvements in relation to these concerns.

   There should be recognition of other constraints, particularly relating to costs and resources, particularly for smaller companies. However, we believe that the current requirements appropriately balance the cost-benefit issue in relation to the cost of producing reports against the value they add.

3. *Does the information provided reflect the issues discussed by directors in board meetings?*

   A variety of issues may be discussed at the board meeting and they may not all be covered in the narrative reporting. However, we consider that the current requirements should lead companies to report on the issues the board has considered in relation to the relevant topics. We also consider that the work of the board committees should also be covered within the narrative reporting framework more thoroughly. In our experience, it is the area of committee work that some of the most frequent boilerplating occurs.

4. *Does the information help shareholders to press directors on key issues relating to strategy and risk, or inform their business decisions?*

Narrative reporting can be an essential tool in enabling investors to understand the issues facing the business and its long-term strategy. Therefore, the information provided can be of immense value. It may also be the case, that where a company does not cover an issue investors may raise its absence when engaging. In all such areas, it is the materiality issue that is the key. There is a significant danger that any move away from the principle of materiality will merely increase the volume of reporting and decrease its relevance to investors. If this were to happen, it would actually may it harder for investors to engage with companies.

5. *If a company does not provide sufficient or material information to you, do you challenge it? Is there anything which could help you to do so?*

   Institutional investors do challenge companies where appropriate on issues relating to the content of narrative reporting. The degree of this challenge will vary according to the nature and interests of a particular shareholder. The nature of this challenge may also vary, with some investors engaging privately, whilst others may seek to be public with their concerns. Again, these differences reflect the aims, interests and styles of the investors concerned.

   We consider that the new UK Investor Stewardship Code may be helpful in this area as it will help clarify the aims and activities of various fund managers. It may also, through its encouragement of collective engagement, enable investors to work together on appropriate issues, including those covered in the narrative reporting.

6. *What other sources of company information do you use and how valuable are they (e.g. information provided on the website, analysts' briefings, dialogue with the company, corporate social responsibility report)?*

   Institutional investors use a wide variety of sources of information, including those mentioned above. The value they contribute will very much depend on the reason that the investment manager is seeking information, their aims and investment styles.

7. *Is there scope to reduce or simplify the requirements on which companies report?*

   We believe that the current requirements are adequate and that they provide companies with the appropriate flexibility in relation to the nature and scope of disclosures, whilst retaining the focus on the need to disclosure relevant and material information.

8. *Is there scope to arrange the information in a more useful way?*

Narrative Reporting will continue to develop in both substance and form over time. We do not consider that presently there is a major need for a substantial overhaul of how it is arranged. However, we believe that a combination of best practice standards and market pressures will lead to it continuing to develop. We would caution against any moves to fragment the core elements of narrative reporting, such as by producing various documents in addition to the annual reporting. The key to effective reporting is that it does have a clear narrative that allows for a description of the key areas. This can be undermined by fragmentation, which can also create complexity and harm understanding.

Business Review

9. *Looking at an Operating & Financial Review and the existing business review, do you see value in reinstating elements of an OFR and if so what would they be? In particular, would a statutory reporting standard help to improve the quality of reporting?*

   The ABI and its members supported the introduction of the OFR and therefore we do not object in principal to its reintroduction. However, much of what was covered in the OFR was enshrined in law in the 2006 Companies Act under the requirement to produce an Enhanced Business Review ('EBR').

   The substantive difference between the OFR and the EBR was in relation to the role of the statutory auditor. There are various views regarding increasing the role of the auditor in relation to assurance under the OFR and considerable concerns that this will merely increase the fees paid to auditors with no corresponding benefits. Verification and assurance can be important, particularly at high impact companies, however we believe that more thought needs to be given to how an appropriate framework can be constructed that reflects the need for assurance, but ensures a proportionate approach reflecting the wide varieties of companies that are covered under the narrative reporting framework.

10. *The business review provisions require quoted companies to report, to the extent necessary, on:*

    - *Main trends and factors likely to affect the future development, performance and position of the company's business*
    - *Information on environmental matters*
    - *Information on employees*
    - *Information on social and community matters*
    - *Persons with whom the company has essential contractual and other relationships*

i) Is this information useful to you? How do you use it?
ii) Could disclosure be improved? If so, how?
iii) Are there key issues which are missing? If so, please explain?

The information currently provided can be of use, although as noted previously there is scope for improvement. The way in which it is used will vary according to the nature of the interest of the investor involved. The major improvement that could be made would be to encourage companies to focus on the core issues facing the business and clearly explaining its strategy. Materiality remains the core to making narrative reporting truly useful. We would have significant concerns over any moves to increase the volume of the current reporting or widen its scope.

It should also be remembered, that reporting is to shareholders, for the purpose of keeping them informed about the companies' strategy and principal risks and uncertainties, so as to gain a better understanding of the prospects for the long-term success of the company. Should the company wish to expand the reporting, for example to include information for broader stakeholders, it should be able to do so but the reporting requirements should not require this.

11. *Would more guidance be helpful? If so, what form should this take? For example, best practice example, sample Key Performance Indicators, etc?*

It is unclear from the question what form this guidance might take, who would issue it or who would determine best practice examples. Given this, we have concerns that any moves to set such standards would lead to a more tick box approach with little regard to the individual circumstances of the company. The sheer number of UK companies reporting, in a wide variety of sectors, would make it near impossible to produce meaningful or helpful all encompassing guidance or "best practice". We consider therefore that standards are best improved through dialogue between companies and investors, private sector initiatives and a gradual evolution of understanding of the value of reporting.

12. *Should there be a shareholder's advisory vote on the Business review?*

We do not believe on balance that this would be the correct way forward. It is unclear what the purpose of an advisory vote would be, given that UK investors already have votes on the report and accounts, auditors, directors and remuneration. We also believe that, were such a vote introduced, the meanings of negative votes would be unclear. For example, would the vote be on the quality of disclosure

overall, or one specific issue, or indeed one event that the company suffered during the year, such as a significant incident damaging the environment. It would be better for investors to engage directly with the company if they feel disclosure is poor or there are specific concerns.

13. *Are there non-regulatory solutions to increasing quality through better guidance or publishing excellence in business reports? If so, what*?

    We support non-regulatory solutions to improve reporting, such as awards or other recognitions. We are also not against individual sectors or groups seeking to develop helpful and relevant voluntary guidance on reporting.

Directors' Remuneration Report

14. *Do the current disclosure requirements provide clear and usable information about:*

    - *The total remuneration paid to directors, and how this is made up;*
    - *The performance criteria for payments to directors, and how these relate to strategic objectives;*
    - *Company performance against these criteria, so that there is a demonstrate link between pay and performance;*
    - *The process by which directors' remuneration is decided?*

    If not, please explain any views on how this might be improved

    We believe that there is scope for many companies to improve the quality of the remuneration report in two key respects. We consider that there is often little recognition in the report of the need to set out a meaningful remuneration policy which is clearly linked to the overall strategy of the company and takes into account sound risk management. We also consider that remuneration reporting should seek to be more "outcome focused". This means not only describing the performance metrics used to measure performance, but also being clear on what the participants received during the year in respect of the performance achieved. Under both the annual bonus and long-term incentive plans too often awards vest with little description of what levels of performance was achieved. It would also be useful if companies perhaps disclosed the potential benefits available under current and proposed plans.

Potential Costs

15. *If you can provide any information on costs associated either with the existing narrative reporting requirements e.g. preparing your business review or your views on the potential costs and benefits in relation to any of the ideas in this consultation, please give details.*

    We are not in a position to comment on this.