UKSIF

18 October 2010

Jane Leavens
Corporate Law & Governance Directorate
Department for Business, Innovation and Skills
1 Victoria Street
London, SW1H 0ET
Email: Narrativereporting@bis.gsi.gov.uk

Dear Jane

Consultation on the Future of Narrative Reporting

Thank you for the opportunity to respond to your consultation. We have focused our response on a limited number of the questions.

Responses to Consultation Questions:

Value of Narrative Reporting

Question One: Are company directors providing useful and relevant information on the company's

1) **Forward-looking strategy and**
2) **Principal risks and opportunities?**

Many of UKSIF's institutional investment members are of the view that UK companies' reporting is generally of a higher quality than that of companies reporting under other jurisdictions. These responsible investors also recognise that many companies have made progress and improvements in the last few years in their narrative reporting and that many Business Reviews are generating useful (material) information.

However, the Business Review is not working well enough. Most Business Reviews are not generating the data, reassurance or forward looking strategic and material information that investors want, including on sustainability issues that are material to company performance.

Indeed, at a recent roundtable that UKSIF convened, the consensus view amongst the participating institutional investors was that:

- Most narrative report is not forward looking enough
- There is varying quality in companies' reporting, with a large number of laggards
- The tendency towards "boiler-plate" reporting is a concern as investors are seeking more tailored reporting by companies that better focuses on their principal risks and opportunities
- There is a general lack of data and Key Performance Indicators included in Business Reviews

In seeking improved narrative reporting, investors are not necessarily seeking an overall increase in the volume of company reporting or the workload required from companies.

Question Four: Does the information help shareholders to press directors on key issues relating to strategy and risk, or inform their business decisions?

The Government may wish to assess the degree to which, if at all, annual reports currently affect investment decisions. The anecdotal information we have gathered is that in many cases fund managers give little attention to annual reports.

The annual report should provide investors with information on how a board arrives at what is material. We support the Financial Reporting Council's calls for 'cutting clutter', better structure and for a greater link between the 'front and back ends' of the annual report in order that financial information is presented in the context of business strategy.

One area of information that needs to come out more in annual reports is how a board arrives at what is material. A sound, related principle that should be established is that directors should explain what their forward looking time period is. This principle would help recognise that different companies have materially different time horizons.

There should also be greater transparency over omissions. Directors should be more explicit on the reasons why information is not provided. This will help shareholders press directors.

Business Review

Question Nine: Looking at an OFR and the existing business review, do you see particular 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?

UKSIF supports the objectives, principles and approach of an Operating and Financial Review. We encourage Government to consider the reintroduction of an enhanced audit requirement and statutory recognition of a reporting standard.

The Accounting Standards Board Reporting Statement (RS1) should be considered as a starting point for improving company reporting on strategy and material information. This is not because the existing Business Review is defective, but rather that RS1 has a number of valuable provisions.

In suggesting RS1 as a starting point, we do recognise that a number of improvements need to be made to the Standard, particularly if there is a "comply or explain" or statutory requirement on companies against the Standard.

Auditing and assurance are also an important – but not sufficient - step to increase shareholders' confidence in the information provided in a narrative report and to improve the quality of engagement between a company and its shareholders. The focus of auditing and assurance should be on management systems and process; for example on whether a substantive and well informed board discussion had taken place where directors were considering their duties to stakeholders (s172 of the Companies Act) and how these would be enacted and reported on.

In considering reintroducing auditing requirements, the Government should consult further with investors, companies and other stakeholders to determine whether a voluntary "comply or explain" system or a statutory requirement would be more effective.

Question 12: Should there be a shareholder's advisory vote on the Business Review?

UKSIF would recommend that the Government considers an advisory vote on a report on company strategy and performance on material sustainability issues before considering an advisory vote on the Business Review. Our view is that this may better help shareholders engage with directors and that ultimately it is more likely to drive up company performance, particularly if the reporting is forward looking.

There are a number of good arguments in favour of an advisory vote on the Business Review. These include:

- Voting helps bring the issues front of mind
- It may help empower individual (retail) investors
- It can stop companies claiming that an investor who raises concerns about an issue is the only one doing so (something that a number of investors have experienced)

However the following concerns, amongst others, indicate that an advisory vote on the Business Review may not achieve desirable outcomes:

- Voting against a Business Review may be a blunt instrument as given the breadth of issues covered by the Business Review, it may not be clear to Directors the reason why an investor has voted against
- Moreover, shareholders can vote against the Annual Report which may have more impact
- This issue of cost and resources required for investors to vote on Business Reviews of numerous listed companies it holds shares in may result in voting becoming a 'tick box exercise'

A more focussed advisory vote on a sustainability report may achieve the benefits and desired outcomes more effectively, whilst mitigating some of the problems identified above.

Directors' Remuneration Report

Question 14: Do the current disclosure requirements provide clear and useful information about:

- **Total remuneration paid to directors**
- **Performance criteria**
- **Company performance**
- **The process by which directors' remuneration is decided?**

Disclosure on remuneration needs to better embed corporate governance and environmental and social reporting and performance.

However, introducing too prescriptive a methodology on remuneration and how it is reported may lead to unintended consequences and may not provide the information required by shareholders to better assess the company's remuneration approach and the performance of the remuneration committee.

The Government may wish to consider the relevant sections of the ABI Guidelines on Responsible Investment Disclosure (www.ivis.co.uk/ResponsibleInvestmentDisclosure.aspx) as a good practice guide in this regard.

UKSIF – the Sustainable Investment and Finance Association

UKSIF, the sustainable investment and finance association, promotes responsible investment and other forms of finance that support sustainable economic development, enhance quality of life and safeguard the environment. We also seek to ensure that individual and institutional investors can reflect their values in their investments. We aim to support the UK finance sector to be the world leader in advancing sustainable development through financial services.

UKSIF was created in 1991 to bring together the different strands of sustainable and responsible finance nationally and to act as a focus and a voice for the industry. UKSIF's 200+ members and affiliates include pension funds, institutional and retail fund managers, investment banks, financial advisers, research providers, consultants, trade unions, banks, building societies and non-governmental organisations. For more information about UKSIF, please visit www.uksif.org.

UKSIF supports long-term responsible investment and ownership. It focuses its corporate governance support on the interface between governance on the one hand and social, environmental and ethical issues on the other.

With best wishes

Adam Ognall

Deputy Chief Executive
UKSIF – the sustainable investment and finance association