BIS | Department for Business Innovation & Skills

# Consultation response form: The Future of Narrative Reporting

A copy of the consultation available at: http://www.bis.gov.uk/consultations.

Responses to the Consultation to be received by 19 October 2010

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**Please tick the box from the following list of options that best describes you:**

| | |
|---|---|
| | **Quoted company** |
| | **Other company** |
| ✓ | **Investor or investment manager** |
| | **Business representative organisation** |
| | **Investor representative organisation** |
| | **Non governmental organisation (NGO)** |
| | **Trade Union** |
| | **Lawyer or accountant** |
| | **Other (e.g. consultant or private individual)** |

## Value of narrative reporting

**<u>Question 1</u>: Are company directors providing useful and relevant information on the company's:**

**i) forward-looking strategy and**
**ii) principal risks and opportunities?**

| Comments |
| --- |
| LGIM feels that Company directors are providing information on forward-looking strategy and principal risks and opportunities to a certain extent.<br><br>LGIM believes that communication can be improved by companies disclosing information that is put in a more relevant context. For example, companies could provide key risks in the sector and/or in comparison with their industry peers thereby providing more transparency and enabling investors to better evaluate the company's performance.<br><br>Furthermore, in relation to companies that operate on a global scale, information regarding how they operate in certain regions will enable investors to gain a greater understanding of their culture and make cross-border comparisons. |

**<u>Question 2:</u> What are the constraints on companies providing information on these issues?**

| Comments |
| --- |
| LGIM understands that on certain occasions, companies will not disclose commercially sensitive information or anything that may put them at a competitive disadvantage. In addition, companies may limit disclosure to avoid guiding the market with false expectations.<br><br>Nevertheless, LGIM expect companies to provide general disclosure on strategy enabling investors to forecast the future direction of the company's performance and to understand its vision. |

**<u>Question 3:</u> Does the information provided reflect the issues discussed by the directors in board meetings?**

| Comments |
| --- |

As an institutional investor, LGIM is observing companies externally and therefore does not participate in boardroom or committee meetings.

LGIM expects key issues and risks regarding strategy to be discussed by the whole board, however, directors are privy to some sensitive information which is not expected to be disclosed to market participants.

**<u>Question 4</u>: Does the information help shareholders to press directors on key issues relating to strategy and risk, or inform their business decisions?**

| Comments |
| --- |
| Yes. LGIM uses the information provided by directors as a trigger for engagement.<br><br>For example, when information is missing or whether to align expectations, engagement is often found to be the most useful tool for discussion on key issues. Furthermore, by entering in to dialogue with companies, a long term relationship is formed which is important for communication in stressed situations. |

**<u>Question 5</u>: 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?**

| Comments |
| --- |
| LGIM does challenge information which is not disclosed by companies and is always in active dialogue to discuss these issues. In some circumstances, this information is provided on request by companies.<br><br>The UK Stewardship Code which was published by the Financial Reporting Council (FRC) in July is a useful stimulus that promotes investors to collectively engage and challenge management information to find common commercial ground. |

**<u>Question 6:</u> 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)?**

| Comments |
| --- |
| LGIM utilises the Company's corporate website as another important source for information.<br><br>The website may be used by a variety of users for a multiple of reasons, but CSR reporting is serving limited purpose in providing investors with |

information that is pertinent to the company's operations and strategy.

The main material risk and opportunities to the company and its sector should be stated clearly within the main Annual Report and Accounts and all information provided should be in relation to them in a manner that is consistent and comparable over different periods and within the sector. Such information should be monitored against clear targets, where relevant, and audited independently.

Extra information which is of use to understand the company's approach and corporate responsibility may still be expressed as a supplement, but not necessarily as a tool for investors.

**<u>Question 7:</u> Is there scope to reduce or simplify the requirements on which companies report?**

| Comments |
| --- |
| Yes. LGIM feels that the information disclosed by companies in the Annual Report & Accounts can be structured and presented in a more basic form, much like the US system and its SEC Form 20-F which has standardise reporting requirements. This simplifies information for investors whilst still enabling them to evaluate investments.<br><br>In relation to Social and Environmental issues, key points should be disclosed in the companies Annual Report & Accounts with the redirection of supplementary information to other sources such as the company's website. |

**<u>Question 8:</u> Is there scope to arrange the information in a more useful way?**

| Comments |
| --- |
| Yes. Narrative reporting by companies can be presented and arranged in certain formats which adhere to industry wide standards. |

## Business Review

**<u>Question 9</u>: Looking at an Operating & Financial Review and the existing business review (see Annex D), 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?**

| Comments |
| --- |
| Although LGIM acknowledges the value of having the OFR and it being externally audited, there remains the risk that standardise responses will be used by companies.<br><br>LGIM believes that the Business Review should contain the company's future assumptions based on current facts and trends. These current facts should be audited enabling investors to compare and come to their own conclusions on what was said previously. |

**<u>Question 10</u>: 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?**

| Comments |
| --- |
| LGIM believes that the business review is an important element in corporate reporting. The business review should demonstrate the main trends and external factors that are likely to affect the company, its employees, its supply chain and its environment, explaining why it is significant to them and/or the industry as a whole.<br><br>The information disclosed should focus on the future but also should be substantiated by facts which are verifiable by independent sources. |

It should also state what the company will do to address such issues with reference to where policy, responsibility of management, targets levels and use of Key Performance Indicators are stated.

While the forward looking information would not be binding, this information should be linked to future reporting on progress which should be audited and verified externally.

This information is important to LGIM when used for entering in to dialogue with companies as it demonstrates the company's recognition of external financial and non-financial factors affecting their long term value. We would also engage on an ongoing basis to monitor the company’s progress over time.

**<u>Question 11:</u> Would more guidance be helpful? If so, what form should this take? For example, best practice example, sample Key Performance Indicators, etc?**

| Comments |
| --- |
| Following the guidance of appropriate disclosure for each industry is important, though it is not necessarily a question of 'more' but consolidating what's already available and used.<br><br>It is important to note that the best practice in an industry may not always be appropriate for the company and it should aim to link the stated material risks to the presentation of data. In this instance, it is not about more guidance but the quality of the information. |

**<u>Question 12:</u> Should there be a shareholder's advisory vote on the Business Review?**

| Comments |
| --- |
| No. LGIM feels that there is no benefit for shareholders to vote on the Business Review as they can already vote on the Annual Report & Accounts if not satisfied with disclosure. In addition, as a long term institutional shareholder, LGIM often engages with companies in advance to inform them of our voting intentions. This encourages dialogue and highlights our concerns directly with the Company so that it can be improved. |

**<u>Question 13</u>: Are there non-regulatory solutions to increasing quality through better guidance or publicising excellence in business reports? If so, what?**

| Comments |
| --- |
| Yes. LGIM feels that there are non-regulatory solutions to increasing the quality of business reports.<br><br>One way this can be achieved is by encouraging companies to collectively agree with their industry peers and stakeholders on the information that should be disclosed on certain issues. By doing this, best practice principles can be developed. |

For example, in the mining sector, the Global Reporting Initiative (GRI) encourages companies to provide key information on its mining activities. Furthermore, by providing information in this format, it reduces the reporting in the Annual Report & Accounts and enables a reporting standard to be set in the industry.

## Directors' Remuneration Report

**Question 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 the company's strategic objectives;**
- **company performance against these criteria, so that there is a demonstrable link between pay and performance.;**
- **the process by which directors' remuneration is decided?**

| Comments |
| --- |
| LGIM acknowledges that the level of disclosure regarding executive remuneration has improved over the years.<br><br>However, the disclosure related to annual bonuses still lacks substance and value. Fundamentally, the annual bonus is an area where many companies find it difficult to provide information for the year ahead due to market sensitivity. Nevertheless, LGIM believes that once the bonus has been paid, disclosing basic information such as the threshold target level would not be sensitive.<br><br>A second area that could be improved relates to the use of benchmark data. Many companies do not fully explain the reason for choosing certain benchmarks. Therefore, investors are unable to make a judgement on whether this benchmark data has been used appropriately. When reporting on this information in the Annual Report & Accounts, LGIM would like to see companies disclose what benchmarks they have used, why it was chosen and how their financial performance or value compares to that of the benchmark.<br><br>Lastly, in relation to Long Term Incentive Plans, LGIM believes companies should provide full details of all measures used and how awards have vested and been calculated. Any remuneration discretion exercised by the Committee should be fully explained with the reason for its application and the incremental value transferred as a result. |

## Costs

**Question 15:**

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

| Comments |
| --- |
| **N/A** |

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