Jane Leavens
Corporate Law & Governance Directorate
Department for Business, Innovation and Skills
1 Victoria Street
London
SW1H 0ET

Narrativereporting@bis.gsi.gov.uk

19th October 2010

Re: Consultation response: the Future of Narrative Reporting

Dear Ms Leavens

Background

Aviva Investors is a global asset management company wholly owned by Aviva plc, the world's sixth largest insurance group, and the largest insurance services provider in the UK. We have assets under management in excess of £250 billion.

Aviva plc believes that good corporate governance and strong, responsible leadership by the corporate board is critical to creating long term shareholder value. We therefore support the disclosure of information from companies on their stewardship of the company in that context. Such information enables us to integrate environmental, social and corporate governance assessments into our valuations on companies. This helps to ensure that capital flows towards companies that are run in a more sustainable way, which also supports the broader economy.

Markets are driven by information. If the information they receive is short term and thin then these characteristics will define our markets. Progressive companies around the world have come to understand that long term shareholder value is enhanced by embedding sustainability into their long term strategy and by fully disclosing their progress to investors. Only when investors have access to high quality, business relevant information will we be able to properly assess one company relative to its peers and allocate capital accordingly.

Consequently, we agree with the statement in the consultation that UK companies are already among the best in the world in their standards of corporate governance and the quality of their narrative reporting. The provision in company law for a Business Review has generated considerable improvement in this area, particularly around material environmental and social performance questions. However, significant problems remain with the quantity, quality, reliability and comparability of this data. We therefore welcome the reconsideration of an Operating and Financial Review, which we believe would have considerable merit.

We further agree that the key goal is to ensure that companies are clear-sighted and focused on the issues which matter to their long term success and therefore to investors. We

also agree that it is important that there is a clear link between the company's strategic objectives and the criteria for payments to directors.

For our part, we believe that a systematic approach to reviewing the standards, values and sustainability risks and opportunities of the business and ensuring that the business knows what is expected helps define and maintain a healthy long term organisational culture, where people have pride in their business, care for their customers and are highly motivated at their work. Understanding the potential impacts on the firm from diminishing access to raw materials is also important to the long term health of the business.

However, over and above the current focus on environmental and social issues within the OFR, we should not lose sight of the opportunity to enhance the linkage between all the many other strategic and material aspects of the business. Among those business aspects that we would expect OFRs to include are: a review of the business strategy; the key performance indicators being used by the board; how the company ensures that the board itself is fit for purpose; and the high level links between the strategy, the business KPIs and the boards' own remuneration (which we would expect to be detailed in the separate remuneration report). In other words, the OFR should be holistic and cover all aspects of the business. In this way, shareholders will be able to see how the business is run as a whole.

Detailed response to consultation form

Name: Steve Waygood

Organisation (if applicable): Aviva Investors

Address: Head of Sustainability Research and Engagement, Aviva Investors, 1 Poultry, London, EC2R 8EJ

Email:

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)

AVIVA INVESTORS

Value of narrative reporting

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

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

Comments

Section 417 of the UK Companies Act which covers the business review has made a major contribution to the availability of useful and relevant narrative reporting. However, in aggregate, business reviews still have considerable room for improvement, not least generating the data, reassurance or forward looking strategic/material sustainability information that investors want.

We look for a thoughtful and sufficiently forward looking business review that covers the company strategy, objectives and operating environment. We also expect to find sufficient evidence that the key corporate responsibility risks have been considered and that action has been taken to mitigate these risks.

Overall, very little of the information that we receive is sufficiently forward looking. It is also much more based on risk management than seizing opportunities to generate revenue. Finally, there is an unhelpful tendency among some companies to produce reports that are far too lengthy and not focused on business relevant issues.

Question 2: What are the constraints on companies providing information on these issues?

Comments

This question is mainly directed at companies providing the data and we defer to them to respond. Among the complaints that we have heard are (i) the lack of useful guidance, (ii) the challenges associated with setting aside the time required to properly discuss these issues at the board level and (iii) a lack of coherent demands from investors.

Question 3: Does the information provided reflect the issues discussed by the directors in board meetings?

Comments

This question is mainly directed at companies providing the data and we defer to them to respond. However, we would observe that we have noticed that a minority of companies appear to cut and paste the sustainability section from the previous years report.

The Corporate Responsibility Board Committee of Aviva plc which is responsible for setting guidance, direction and overseeing policies and progress on the Group's corporate responsibility (CR) and Environmental policy reports to the Board at regular intervals informing the directors of the matters it has reviewed and making recommendations when appropriate. The Committee's duties and activities during the year are disclosed in the Annual Report and Accounts.

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

Comments

Yes, but there is scope for improvement. Similarly, following the advent of s417, we have found that our requests for the information are responded to positively more regularly. In other words, it has helped to create the norm that this information is valid and necessary.

Question 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?

Comments

Yes. In addition to our answer to question four above, since 2001 it has been our approach to vote against a report and accounts of a company if it does not disclose what we consider to be material corporate responsibility performance information. Appendix 1 contains some information highlighting the results of this work. It also includes a series of brief case studies depicting our approach. They demonstrate improvements in the narrative reporting from Renishaw PLC, G4S, Elekta AB, Chloride Group, Daejan Holdings PLC, Dana Petroleum, and Carpetright.

In terms of measures that would help, we would prefer to have the opportunity to vote specifically on the sustainability information in the report and accounts (see question 12 for our proposed structure to this). While the vote would enable better market self-regulation, we are also of the view that the role of the FRC (FRRP) should be revisited and re-energized. Indeed, until recently, we were not aware that the FRC operated a service to investors having problems engaging with companies in the furtherance of good business reviews. The function needs far greater publicity as well as more resources.

Question 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)?**

Comments

We do not restrict ourselves to the information contained within a company's report and accounts. We also find valuable information on the website, analysts' briefings, broker reports, dialogue with the company and the corporate responsibility report. We also use specialist research providers such as PIRC, EIRIS, ISS, Governance Metrics International, as well as speaking with various non governmental bodies.

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

Comments

When reporting to investors, companies should prioritise disclosure of corporate responsibility issues that are most relevant to their business. We look for the integration of relevant issues into the financial reports, as this is most helpful to investors. Best practice increasingly involves their consideration in the chairman and chief executive's statements, the business review, the remuneration report, internal control statements and the audit report. We welcome stand alone corporate responsibility reports, particularly when they are justified by the nature and scale of the issues, as well as the depth of the company's response.

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

Comments

We welcome the work of the International Integrated Reporting Committee and would recommend that BIS give consideration to how this work can be furthered within Company Law.

Aviva plc was heavily involved with the Prince of Wales' Initiative on Accounting for Sustainability. When this came out with its report, it was actually implemented it the 2008 annual report, allowing investors to see how the company deals with greenhouse gas emissions, waste and resources

Business Review

Question 9: **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?**

AVIVA INVESTORS

Comments

Yes. We see a number of valuable contributions from reinstating elements of the OFR: (i) the opportunity to tie in voting action; (ii) the opportunity to revisit the role of the auditor in signing off the accuracy of any key performance indicators as well as signing off on whether a substantive and well informed board discussion had taken place where directors were considering their duties to stakeholders (s172), (iii) the opportunity to develop better guidance for companies, and (iv) the opportunity to embed this information into director's incentives.

As to the establishment of a statutory reporting standard, while a general process standard for integrated reporting with key performance indicators can be stipulated as a minimum, we do not consider it appropriate to set a one size fits all reporting standard covering the broad range of risks and opportunities that exist and the different ways in which they apply to different companies.

Question 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?

Comments

Yes. We embed the material information into both our stock selection for client portfolios as well as in our voting decisions at company AGMs.

We have seen a significant increase in the number of companies disclosing corporate responsibility issues within the annual report and accounts. We consider that this is mainly attributable to the 2008 changes to company law, and is consistent with the trend that we have seen since we started voting on these issues in 2001.

However, we still have concerns about the quality and usefulness of this information. One recurring theme has been the lack of the key performance indicators (KPIs) on material issues. We find that KPIs are a simple and effective tool for measuring performance and management quality in this area. While the Companies Act also highlights their importance, the lack of key performance indicators has been our most frequent request in feedback to companies.

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

Comments

Yes. The guidance could take ASB 1 as its starting point and revisit that in conjunction with the ABI Guidelines for Responsible Investment disclosure, Bloomberg, and the integrated reporting framework from Accounting for Sustainability.

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

Comments

Our experience with voting on report and accounts demonstrates that, while effective with around 40-50% of companies responding, our communication would be more efficient and focused if we had a stand alone vote available to us.

Our experience using the vote on the annual report and accounts demonstrates that it is a useful and effective surrogate for the vote proposed here. However, we would prefer to have the opportunity to vote specifically on the sustainability information in the report and accounts. Not least because this would avoid the signals being given to companies becoming mixed up among many of the other reasons that a vote on the annual report and accounts is used. To that end, we strongly welcome the considerations being given to harnessing this disclosure to investor voting activity at company AGMs.

However, we note that the question is whether the OFR/Business Review should be put to an advisory vote at the company's AGM. While we can certainly see the case for this, we would prefer a more focused vote on a separate section in the report which would contain the future sustainability strategy and backward looking performance report. Such a vote would be an even more focused and effective device. We believe that a vote would help to ensure that directors take appropriate care in preparing the information.

Such a section need not be lengthy, and could be supported by further information on line. Regarding the key difference between a sustainability report and a sustainability strategy, a report is backward looking and reports on performance to date - ideally with 3-5 year trend analysis. Whereas a sustainability strategy looks out 20-30 years or more and considers how the company will ensure that it remains a going concern over this time period and beyond. Depending on the sector, questions that we look to see covered include, for example, what natural resources does the company depend on, and how can they be sustained indefinitely. What levels of training within the workforce does the company require, and how can it ensure that this is in place. How can the local communities within which the business operates develop economically and contribute to the longer term development of the company. Does the business model of the company need to evolve in order to ensure that it helps to meet the needs of the present, without encumbering the ability of future generations to meet

their own needs? What is the regulatory context regarding sustainable development issues likely to look like, and how will this change corporate cash flows? How can the company maximize the opportunities for creating and sustaining a competitive advantage?

Our parent company Aviva plc experimented with this approach at its 2010 AGM earlier this year by putting their CR report to an advisory vote. It has reported to us that it found the conversations with the vast majority of its shareholders to be productive and supportive, with a 99.97% vote in favour.

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

Comments

We believe that the approach implied by the current line of questioning is the right one.

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

Although there has been a gradual move to align performance measures towards those that are more consistent with company strategy, profitable growth and long-term value creation, this trend has been slow with, for example, EPS too prevalent as a measure, despite its shortcomings. Similarly, the disclosure and explanation of the levels of variable pay vesting (bonuses and incentive schemes) in relation to the performance outcomes remains poor.

Our policy on the integration of environmental, social and corporate governance (ESG) issues into remuneration is a relatively recent development. A 2008 broker note by JP Morgan analysed whether the remuneration strategies of 174 pan-European companies made any reference to ESG or non-financial factors. They found that 61 companies included some ESG reference; at 13 companies the

consideration of ESG factors was discretionary and 13 companies drew a quantitative link. Aviva plc was singled out as a good performer in its sector.

The approach that we recommend here is consistent with the ABI Guidelines on Responsible Investment disclosure, ie:

"*With regard to the Board, the company should state in its remuneration report:*

3.1 Whether the remuneration committee is able to consider corporate performance on ESG issues when setting remuneration of executive directors. If the report states that the committee has no such discretion, then a reason should be provided for its absence.

3.2 Whether the remuneration committee has ensured that the incentive structure for senior management does not raise ESG risks by inadvertently motivating irresponsible behaviour."

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

Companies frequently complain that their shareholders are too short term. Consequently, they should support shareholder requests for performance data that is relevant to the long term.

For those companies already producing a sustainability or corporate responsibility report, the additional costs of presenting it to the AGM are trivial. For example, Aviva PLC tabled its Corporate Responsibility vote to the 2010 AGM. As mentioned above, the approximate costs in time were no more than 5 person days, and less than £5,000. This report won the support of 99.97% of the investors that voted. For a company with a market capitalisation in excess of £10 billion, the benefits of tabling the report at the AGM were significantly greater than the costs which we would also expect to decline in future years (Source: Aviva plc).

It is true that those companies not disclosing any data will have more significant costs in terms of time and money. However, we would argue that the consideration and publication of such a report - as well as the production of the associated management information - will help companies to identify efficiency savings and create value for shareholders.

For our part, we believe that a systematic approach to reviewing the standards,

values and sustainability risks and opportunities of the business and ensuring that the business knows what is expected helps define and maintain a healthy long term organisational culture, where people have pride in their business, care for their customers and are highly motivated at their work. Understanding the potential impacts on the firm from diminishing access to raw materials is also important to the long term health of the business.

A significant number of buy and sell side firms are integrating these issues into valuation. However, without performance reporting, this is extremely difficult.

To cite two examples:

Goldman Sachs is one of the firms to have carried out analysis of the relationship between how companies address these ESG issues and the returns they generate. It contends that in a number of sectors there is a direct correlation between sustainable business practices and the longer-term financial success of that company.

WestLB also published a study of the materiality of extra-financial factors based on a sample of 540 European firm. It found evidence of a link between extra-financial risk, cost of capital to a firm and shareholder value. The report suggested that compiling a sustainability report was among the most important ESG catalysts for change – contributing to accumulation of knowledge, questioning of processes and the establishment of suitable structures and practices (Source: Garz, H & Volk, C. What really counts: The materiality of extra-financial factors, WestLB, February 2007).

Conclusion:

While corporate narrative reporting in the UK is already among the best in the world, we believe that there is a need to reinstate the operating and financial review. We believe that this will help to achieve the first aim of the consultation, which is to drive up the quality of narrative reporting to the level of the best, including on social and environmental issues. We strongly welcome the suggestion that voting action could be embedded in some way, as this will help to achieve the second aim of the consultation and empower shareholders so they can step up and act as effective owners in the long term interests of the companies they invest in.

We also agree that it is important that there is a clear link between the company's strategic objectives and the criteria for payments to directors. The approach that we recommend here is that the company should be required to state in its remuneration report whether the remuneration committee is able to consider corporate performance on ESG issues when setting remuneration of executive directors. If the report states that the committee has no such discretion, then a reason should be provided for its absence.

Finally, we would highlight that there are also important links to other policy areas. For example, there are links to the Climate Change Act and its provision for the disclosure of climate change related data. Lord Stern has reminded us that, while the consequences of the financial crisis have been profound, they pale in comparison to the dangers of runaway climate change. His seminal review on the economics of climate change in 2006 made it clear that climate change could represent a significant cost to the global economy. Its main conclusions were that 1% of global GDP should be invested a year to mitigate its effects, and that failure to do so could risk global consumption being up to 20% lower than it otherwise might be. Such an outcome would profoundly affect the long term value of our client's portfolios, so we are supporting and advocating strong government action in this area, starting with mandatory disclosure of greenhouse gas emissions data by large corporations. Consequently, we welcome the new government's commitment for urgent action to decarbonise the economy and support green industries and jobs. As part of this commitment, it is essential that the government ensures that all large organisations measure and report their greenhouse gas (GHG) emissions. This is necessary for business, which is responsible for nearly a third of total UK GHG emissions, to manage and reduce its carbon footprint, leading to reduced energy costs, increased transparency and a greater understanding of material climate risks and opportunities.

Similarly, an OFR could contribute to a further improvement in investment managers' stewardship of clients' ownership interests and rights, and promote the long term health of businesses and create shareholder value. This has of course been the focus of the Financial Reporting Council with the recent launch of its Stewardship Code for Institutional Investors, which Aviva Investors strongly supports. The ultimate objective of good stewardship by investors is to ensure that company Directors are, in turn, good stewards of the business. Investor stewardship relies on information being disclosed by companies regarding on their considerations of and performance in this area, hence the link here.

I am happy to discuss any of the issues covered in this paper further so please do not hesitate to get in contact.

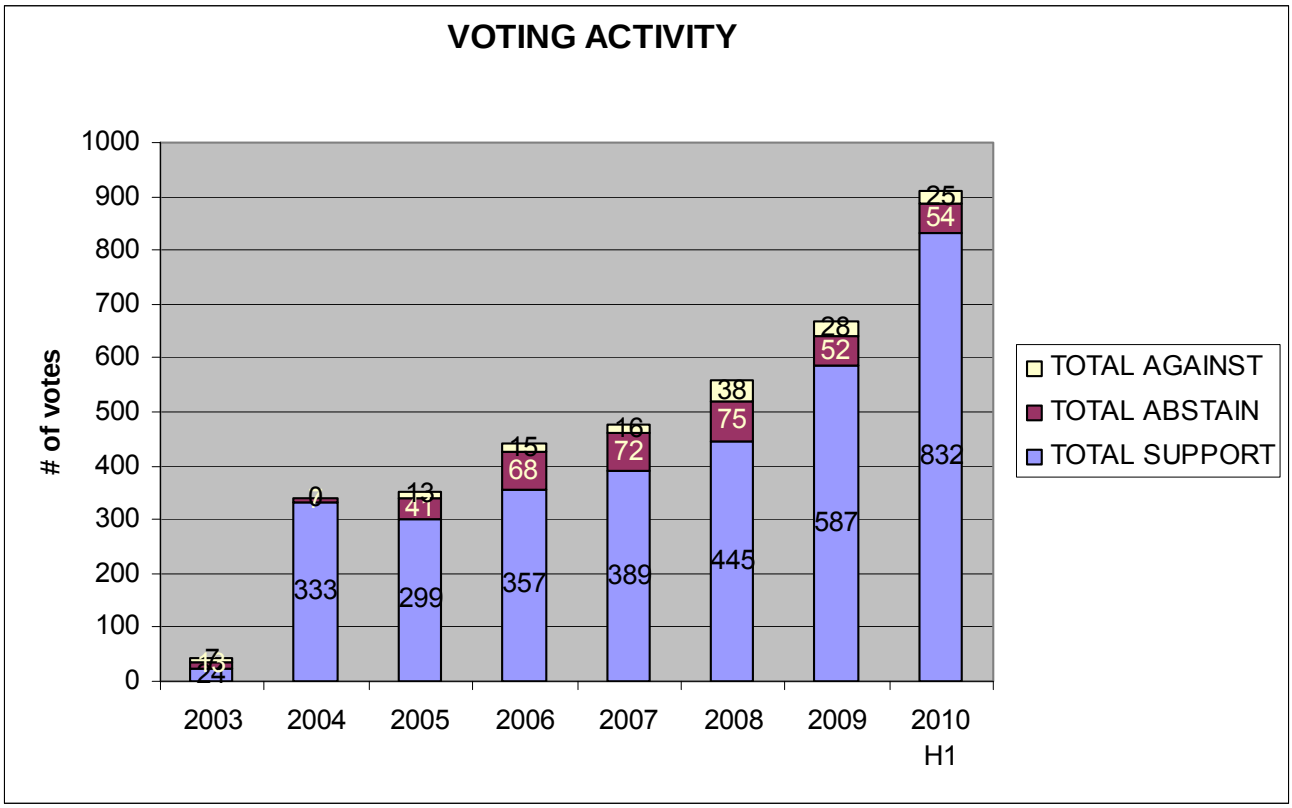
Yours sincerely,

Dr Steve Waygood
Head of Sustainability Research and Engagement
Aviva Investors

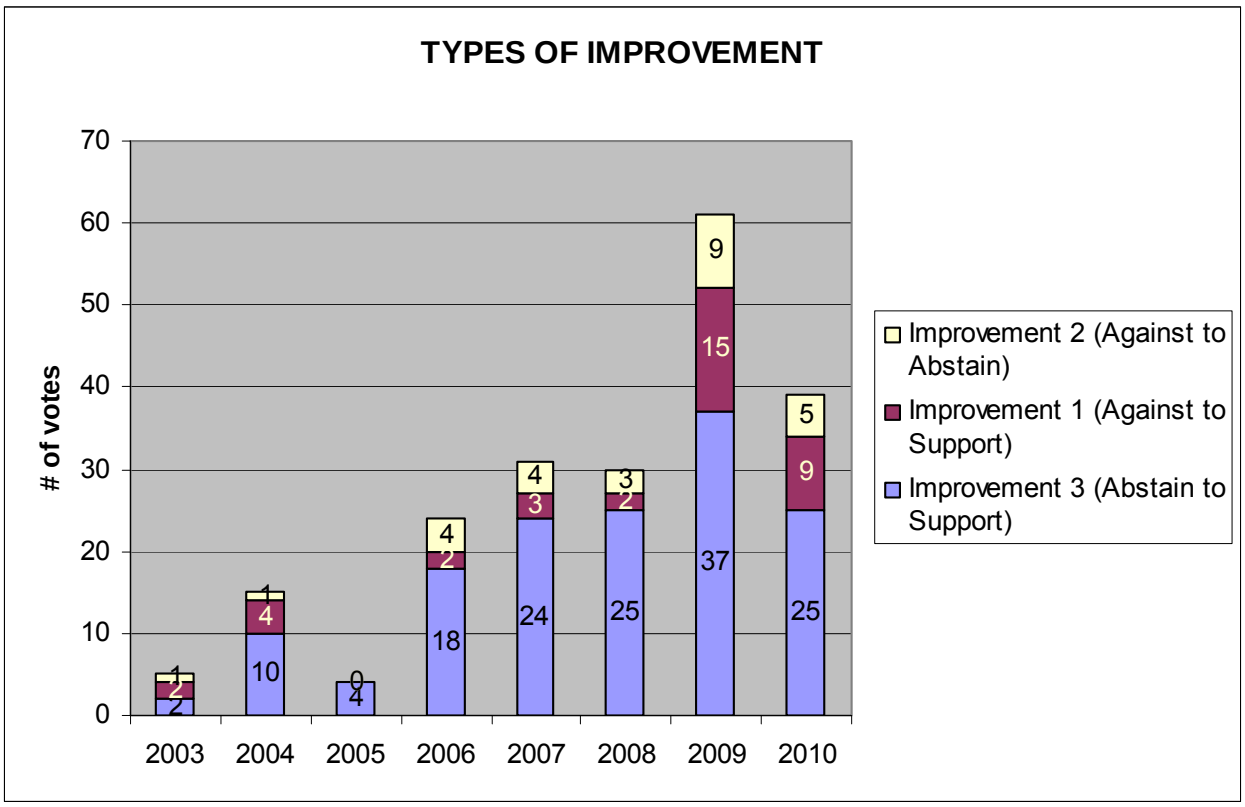
APPENDIX A: An Overview of Aviva Investor's voting on environmental and social performance

Since 2001, it has been our approach to vote against a report and accounts of a company if it does not disclosure what we consider to be material corporate responsibility performance information. At launch, this policy applied to the FTSE100 (ie the largest listed companies in the UK). By 2008, the scope of this policy had been extended to the top 350 in the UK, plus the 300 largest companies in Europe. We now apply it to the FTSE All Share.

An analysis of this voting activity is outlined for the below. The first bar chart below depicts our overall voting levels on Corporate Responsibility disclosure and accountability (this is separate to the additional voting that we do on conventional corporate governance concerns). It shows that our overall voting levels went up, but within that, the number of times we withheld support from the boards of companies decreased. There are a number of reasons for this, including that companies often respond to concerns that we have raised in previous years.



The second bar chart demonstrates how often we are able to increase our levels of support for companies.



The following case studies demonstrate how voting on environmental and social performance questions can generate improved disclosure.

Renishaw PLC

2009 Abstain

The company has included some quantitative data in this year's Annual Report including a breakdown of the workforce in terms of gender, ethnicity and turnover. The company also reports the breakdown in energy use in percentage terms from different sources. This is a welcome development and we will therefore Abstain on the Report and Accounts (where we voted against last year). However, there is still no quantitative environmental performance data (e.g. for energy use, CO2 emissions and waste). We hope to see this remedied in next year's report.

2010 Support

The Company now discloses quantitative greenhouse gas emissions and waste data. This level of disclosure represents an increase in the Company's ESG disclosure and we will therefore vote in support of the Company's accounts and reports.

G4S

In May 2008, Aviva Investors again withheld our support from the report and accounts due to the absence of non financial KPIs, particularly regarding employee health and safety. There were two main reasons why we raised this as a material issue:

1. the company continued its move towards high risk security services and land mine clearing. It is important to know that the impacts on the workforce are being well managed;

2. the company's strategy involved taking greater responsibility for managing risk on behalf of customers, including a range of outsourcing services covering health and safety consultancy, systems, certification, analysis design and operation. Not delivering on these aspects within the business would reduce the credibility of this product.

The company responded that they were aware of the omission and planned to take steps to correct it.

In May 2009 we were able to welcome G4S's first corporate responsibility report and support the report and accounts due to the improvements in reporting of KPIs including H&S. We also recommended further improvements, including greater use of management system certification.

Elekta AB

2009 Abstain

The 2008/09 annual report is not available on their website (01/09/2009) so I am not able to assess and SEE disclosure. Based on last year's disclosure and comments it looks like it should be an Against again (also given the fact their ANR is not available).

2010 Support

The company has now provided some environmental information.

Chloride Group

2009 Abstain

The company discloses quantitative H&S data in terms of accident days but no quantitative environmental data. Recommend Abstain and encourage environmental data disclosure.

2010 Support

This company now provides details of carbon emissions normalised against employee numbers. The company also intends to respond to the CDP this year. This improvement is sufficient for us to vote in support.

Daejan Holdings PLC

2009 Abstain

The company now reports a brief section on CSR in their Annual Report. This includes employee turnover data and minimal disclosure on the environment and community. We would encourage the company to disclose additional information on the environmental impact on properties in which they invest.

2010 Support

Due to the sector in which the company operates in its environmental risks are relatively low. The company does report that it aims to achieve the highest BREEAM certification for all of it of its developments and refurbishments. Ideally we would like to see the company publish more information in this area but given its impact on the environment we are able to support.

Dana Petroleum

2009 Against

We abstained last year on the basis of inadequate reporting offset by strategic improvements and a clear commitment to join the Carbon Disclosure Project. Although improvements have been made disclosure is insufficient and their Carbon Disclosure information has not been made public. This is a high environmental impact company which fails to disclose quantitative environmental performance data or adequate information on its management of human rights - Oppose.

2010 Abstain

We are please to see that this company has shown significant improvement this year in publishing details of its carbon emissions both in brief on its website and in detail to the CDP. This year it has also made its CDP response publicly available. However, no positive steps have been made with reference to human rights with no details of a policy or systems provided in this area. The company has significant oil and gas operations in countries of concern for human rights including Egypt and Kenya. While we do appreciate the improvements made by the company regarding its environmental, and specifically climate change, impacts the lack of human rights disclosure means we are only able to abstain this year.

Carpetright PLC

2009 Against

No real improvement from last year. The company discloses clear aims in the areas of customers, employees, product, H&S and environment, however no quantitative performance data is disclosed (with the exception that all wood products are FSC certified).

2010 Support

The company now provides quantitative data in areas such as health and safety and the environment and so we are now able to support.