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

By e-mail: Narrativereporting@bis.gsi.gov.uk

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Dear Madam

GC100 response to the consultation paper, The Future of Narrative Reporting

I am writing on behalf of the GC100 in response to the above consultation paper. As you may be aware, GC100 is the association for the general counsel and company secretaries of companies in the FTSE 100. There are currently over 120 members of the group, representing some 80 companies.

The GC100 welcomes the opportunity to respond to this consultation, and thanks you for the extension of one week to submit our response, but before addressing each of the paper's questions in turn, we think it would be helpful to set out some general observations.

We do not think it would be appropriate to reintroduce an operating and financial review (OFR). There was extensive debate on this issue under the previous government, resulting in the introduction of the Business Review. While it makes sense to see how well the Business Review is working in practice so far, it would be premature to suggest that we need to revert to the OFR. In this regard, the UK Corporate Governance Code now recommends that companies include a description of their business model. When introducing this change, the FRC stated that "there is currently a gap in reporting and that setting out in layman's terms the company's strategy for generating long term value would enhance the ability of investors and other users of reports to assess the disclosures required under the Business Review". Given that this change only applies to financial years commencing on or after 29 June 2010, our robust view is that now is not the time to introduce yet further change.

In substance, the Business Review and the OFR are broadly similar, the main difference being the reference to the reporting standards in relation to, and a formal auditors' review of, the OFR. Given that auditors review the Business Review for consistency with the audited parts of the report and accounts, there is already a degree of assurance in company reporting and there is certainly no shortage of best practice guidance.

More specifically, given that the content requirements are essentially the same, we cannot see how the introduction of an OFR will, of itself, improve the way that social and environmental duties are addressed.

Section 417 of the Companies Act 2006 requires quoted and large companies to produce a Business Review addressed to shareholders to help them assess how the Directors have performed their duty to promote the success of the Company. The general experience of our members is that there is no noticeable demand on the part of investors for more detailed reporting from the companies in which they invest.

The government has stated that it wishes to achieve coherence without increasing the regulatory burden on businesses. We believe that the current principles-based and flexible reporting regime creates competitive advantage for the UK, while driving standards of corporate reporting which are amongst the best in the world. UK businesses have had to cope with constant changes over the past four years, including the rewriting of the Companies Act (implemented over a number of commencements dates over more than three years); the proposed introduction of the OFR, then changed to the Business Review; revisions to the Combined Code and the introduction of the Stewardship Code; and ongoing changes to the Listing Rules, Prospectus Rules and Disclosure & Transparency Rules for listed issuers. There has also been a plethora of 'best practice' guidance issued by a wide range of bodies in support of the legislative or regulatory change. More change will inevitably cost businesses more, in terms of internal resources and external fees, and erode national competitiveness.

The responses of the GC100 to your specific questions are set out below. Our response focuses on the questions applicable to companies.

Value of narrative reporting

Q1 Are company directors providing useful and relevant information on the company's:
- **i) forward-forward-looking strategy; and**
- **ii) principal risks and uncertainties?**

We believe that these requirements are already adequately covered by existing regulation, which is expressed very clearly. If investors are not satisfied with the way these items are covered, they can ask management for further information but, given the vastly differing natures of companies and their businesses, it is difficult to see how further regulation would improve disclosure in this area.

Q2 What are the constraints on companies providing information on these issues?

So far as strategy is concerned, we believe our member companies generally aim, so far as practicable, to share their aims with investors and stakeholders, but inevitably do so with caution, as there is a danger that some people will regard an explanation of opportunities as definitive commitment. Some ideas might also be commercially sensitive.

In the area of risks, our member companies disclose those risks which their internal reviews identify as the most important. We note that there is a risk of liability if material risks are omitted which later result in losses. While the "safe harbour" in the Companies Act 2006 is helpful, for those with US listings this is a real concern, as witnessed by the growth in disclaimer wordings included in annual reports. Some of our members are also concerned that the disclosure of more detail about risks and uncertainties could give a misleading impression of a company's position.

Q3 Does the information provided reflect the issues discussed by the directors in board meetings?

In our experience, what is disclosed generally reflects what has preoccupied the board throughout the year (subject to materiality, and commercial and political sensitivities). But we do not think it

would be helpful to introduce some sort of requirement that the board should specifically disclose its business.

Q4 Does the information help shareholders to press directors on key issues relating to strategy and risk, or inform their business decisions?

Not applicable.

Q5 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?

Not applicable.

Q6 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)?

Not applicable.

Q7 Is there scope to reduce or simplify the requirements on which companies report?

Not applicable.

Q8 Is there scope to arrange the information in a more useful way?

We think there could be scope to simplfy annual reports by permitting companies to include only the Business Review and accounts in the Annual Report, and publishing other matters (such as static or slow-changing information) on a website. This should not involve any change of content, but investors might find such annual reports easier to access.

Business Review

Q9 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?

As explained above, we would be firmly against the introduction of an OFR. Unless there are serious shortfalls in the way that the Business Review is currently working, it is difficult to see how a statutory reporting standard would help improve the quality of reporting or, more importantly, the management of the underlying issues.

In our experience, the current UK reporting framework is amongst the very best in the world, and UK businesses are well-regarded internationally for the quality of their reporting to shareholders. We would contend that in large part this is due to the principles-based nature of the existing regulatory regime, and the flexibility that this creates. We believe therefore that a more prescriptive regime will actually weaken the quality of narrative reporting as companies are obliged to make 'box-ticking' disclosures rather than attempt real communication. There is also a risk that adding assurance requirements will stifle reporting as auditors struggle to report on opinion type comments and forward looking strategic views.

We note that, under the Prospectus Rules, an OFR must be included in a prospectus, however we would be interested to know if BIS proposes to conduct any research to determine whether investors find it useful. In 2008 the Rights Issue Review Group found that "due to its length and

complexity, most investors do not use the prospectus as a means of information prior to investment decisions" (A Report to the Chancellor of the Exchequer: by the Rights Issue Review Group, November 2008). The Group did not recommend the inclusion of an OFR in its proposed short-form prospectus, which suggests it considered that investors do not value the OFR highly.

Q10 The business review provisions require quoted companies to report, to the extent necessary, on:

- **in 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.

We do not believe that there is any need to increase the level of disclosure on social and environmental issues. While there is currently a requirement to disclosure a certain amount of information of this nature in the Business Review, many companies choose to report more extensively on social and environmental issues using other media, such as hard copy or online sustainability reports, sometimes published at different times to the Annual Report. A requirement to disclose more information in the Business Review will lead to a duplication of work and, for many companies, the Annual Report is not the best medium for this information.

Q11 Would more guidance be helpful? If so, what form should this take? For example: best practice example, sample Key Performance Indicators, etc?

We do not think that further guidance would be useful. We already have adequate input from advisers, shareholders, etc. Companies can determine for themselves which Key Performance Indicators are appropriate for their own particular businesses. In our experience, guidance, such as DEFRA's guidance on environment reporting, doesn't make reporting any easier: companies have differing impacts, and in very different places.

Q12 Should there be a shareholder's advisory vote on the Business Review?

We would not support a shareholder advisory vote on the Business Review. The Business Review should be viewed in the context of the Report and Accounts as a whole. This is required, under section 437 Companies Act 2006, to be 'laid before' the company in general meeting – in practice, companies almost universally offer shareholders the opportunity to 'receive' or 'adopt' the Report and Accounts by means of a vote at the AGM.

Further, a Business Review is, by design, intended to report on a wide range of the company's activities, over varying time spans, including the future. We consider that no useful purpose would be served by an advisory vote as the aim of such a vote by shareholders would be unclear. To witness this further, should a vote on a Business Review reject that document, what is the implication or consequence of such resolution by the companies' shareholders? It could be construed as a lack of confidence in the board or its chosen strategy, but as all directors are likely to seek re-election on an annual basis under the new UK Corporate Governance Code, it is hard to see what additional benefit would have accrued to shareholders from the specific requirement.

Q13 Are there non-regulatory solutions to increasing quality through better guidance or publicising excellence in business reports? If so, what?

While the principle of non-regulatory solutions is attractive, overall basic regulation should ensure an acceptable degree of comparable reporting for all shareholders. In our members' experience, the Financial Reporting Review Panel exerts a significant influence over corporate reporting, as company boards generally wish to avoid investigation by, or referral to, the FRRP.

In any event we doubt whether an annual ranking of companies' Business Reviews would achieve the intended clarity of disclosure. Although a number of companies are motivated about positions in league tables, there are many for whom this would not act as an incentive. Finally, each company is individual and distinct and a comparison of different Business Reviews would not be comparing like with like. Any form of ranking is therefore likely to be arbitrary and artificial.

Q14 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?**

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

The current requirements under the Large and Medium Sized Companies and Groups (Accounts and Reports) Regulations 2008 (Regulations) which relate to the Directors Remuneration Report (DRR) are already prescriptive in terms of the information that companies need to include. Companies complying with these requirements are required to provide details on the total amount paid to directors, including salary, bonus, benefits and any compensation for loss of office as well as share holdings and awards under long term incentive arrangements.

Details on how reward arrangements for executive directors are determined are included within the annual report, including the overall philosophy, information on base salaries, variable compensation awards and retirement benefits.

Performance criteria for long term incentive arrangements are provided in detail in the DRR, and under the requirements of the DRR Regulations a performance graph of the total shareholder return is provided for the previous five years. Details of the individual performance criteria of the executive directors are not disclosed as these vary between each director and, necessarily, are linked to the strategy of the Group. As such it would not be appropriate to disclose this information in a public document.

In summary, the DRR clearly requires the disclosure of information on remuneration policy and processes. Directors' remuneration is broken down so that it is easy to identify different components of the package and presented in an easy to use fashion.

In any event, we query whether the information provided and the remuneration consultancy industry it has spawned, is helping restrain, or has accelerated, growth in executive pay.

Potential Costs

Q15 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.

It is difficult to quantify the costs associated with the existing narrative reporting requirement, but any greater regulatory requirements will inevitably increase costs.

Auditor involvement could add significantly to the costs of preparation.

Please note, as a matter of formality, that the views expressed in this letter do not necessarily reflect those of each and every individual member of the GC100 or their employing companies.

If you would like to discuss any of these points further, we would be happy to do so.

Yours faithfully

Mary Mullally
Secretary, GC100

GC100 Group
The Association of General Counsel and Company Secretaries of the FTSE 100
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Secretary: Mary Mullally ▪ 19 Hatfields, London SE1 8DJ ▪ **T** +44 (0)20 7202 1245 ▪ **F** +44 (0)20 7202 1211 ▪ **E** mary.mullally@practicallaw.com