BLACKROCK

9 December 2015

Paul Smith
Corporate Frameworks, Accountability and Governance
Department of Business, Innovation and Skills
1 Victoria Street
London
SW1H 0ET

Sent electronically to: pauld.smith@bis.gsi.gov.uk

Re: Consultation on the technical legislative implementation of the EU Audit Directive and Regulation

Dear Mr. Smith,

BlackRock, Inc. ("BlackRock")[1] is pleased to have the opportunity to respond to the above consultation on the implementation of the EU Audit Directive and Regulation collectively (the "Legislation").

As a fiduciary for our clients, BlackRock supports a regulatory regime that increases transparency, protects investors, and facilitates responsible growth of capital markets while preserving consumer choice and assessing benefits versus implementation costs.

We welcome the opportunity to address, and comment on, the issues raised by this consultation and we will continue to contribute to the thinking of the Department of Business, Innovation and Skills ("BIS" or the "Government") on any specific issues that may assist in improving the implementation of the Legislation. As financial statements preparers and users, we have a considerable interest in the impact of this Legislation, particularly with regard to our investment funds based in the United Kingdom and throughout Europe.

We have set out our comments to certain of your questions in the following pages. We have responded to the questions we consider relevant to ourselves as a corporate entity, and as an investor on behalf of our clients. Our overriding view is that any available option that restricts the audit committee's ability to determine the most qualified audit firm for specific services should be avoided.

[1] BlackRock is one of the world's leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers and other financial institutions, as well as individuals around the world.

Key points

PIE definition

We support the Government's conclusion not expand the definition of a PIE further and beyond the EU minimum requirement as we believe it would add unwarranted complexity and cost.

70% non-audit fee cap effective date

We welcome BIS stating in this consultation document that the first calculation for the cap must be undertaken in respect of the accounting year beginning on or after 17 June 2019 (i.e. the 4th accounting year beginning after the application of the Regulation). This provides companies with sufficient time to change their non-audit service providers or auditors, if required, in an orderly and considered manner.

Potential extra-territorial application of the legislation

As detailed in our response dated 19th March 2015 to 'Auditor Regulation - Discussion document on the implications of the EU and wider reforms' ("the Discussion Paper") we have concerns that Article 5.4 in the Regulation implies that the PIE's audit committee (or the group audit committee acting on behalf of the PIE) would have to pre-approve all permissible non-audit services provided by the statutory auditor (including its member firms) even if they are to be provided to non-EU parent entities or non-EU controlled undertakings.

We understand that the European Commission's Q&A on Implementation of the new statutory framework dated 3 September 2014 (the European Commission's September 2014 Q&A) in relation to an analogous question "What if the audit client has subsidiaries which operate in different jurisdictions (EU and non-EU) which are required to apply different auditor rotation rules?" clarified that "The Regulation does not have any extraterritorial effects – it applies to PIEs that operate within the EU only. Thus, if a PIE incorporated in the EU has a subsidiary incorporated in a third country, there is no legal obligation upon this PIE to rotate its auditors in this third country, unless the law of the latter states so." Applying this by analogy would result in the PIE's audit committee having a duty to pre-approve non-audit services for controlled undertakings of the PIE and its parent within the EU, not those outside the EU. This is consistent with our interpretation of the Legislation and with the FRC's proposals for group audit firms' assessment of the independence of other auditors of group components as detailed in their consultation document published on September 29th 2015. Accordingly, this is the approach to the Legislation that we will be taking in the absence of clarity to the contrary from the FRC or BIS.

Audit tenure - 10 year extension after a public tender

In order to mitigate the additional risk to a PIE resulting from auditor transition, and to allow the development of institutional knowledge, BlackRock supports the Government's conclusion to allow for the 10 year extension permitted by the Regulation where a public tender has been undertaken. Requiring rotation after 10 years reduces the competitiveness of the tender process and results in additional start-up time and costs for new auditors, which reduces the savings and investment returns for Europe's citizens and employers.

Further, BlackRock supports the Government's clarifications around how it will implement the auditors' maximum duration as illustrated in Figure 7.1 of the consultation. It is important that PIEs are not penalised for more frequent tendering, and accordingly the Government's confirmation that a PIE can retain the same auditor for up to 20 years, regardless of how many tenders it undertakes, provided that the 10 year maximum duration between each tender, is adhered to.

Audit tenure - transitional provisions

As part of our response to the Discussion Paper we welcomed the Government clarifying the tender/rotation timeline where an incumbent auditor of a PIE has been appointed as auditor for fewer than 11 consecutive financial years as at 17 June 2014 through publishing the additional supplementary information which it states that:

"It is true that on 17 June 2016, some audit engagements under the third transitional provision will be of more than 10 years' duration, and up to 13 years' duration. This is because the transitional provision covers audit engagements for financial years that began on or after 17 June 2003. This will be the case for all audit engagements for which the first financial year began between that date and 16 June 2006.

For these audit engagements, we consider that the auditor of the accounts for the financial year beginning before 17 June 2016 is still able to complete the audit of those accounts. However at the start of the first financial year beginning after that date, the auditor could not be reappointed to audit the accounts for that year other than on the b asis of a tender."

This clarification is helpful in removing uncertainty for companies falling into the 'less than eleven years' category where there had been some ambiguity around the financial periods affected. Building on this we support the Government making it clear in the consultation paper that PIEs that have tendered their audit engagement prior to the application date for the Regulation should benefit from transitional recognition of that tender wherever possible. We await the updated guidance being issued by the Government setting out how the transitional provisions should be implemented. We note that the summary example provided in the consultation paper outlines the scenario where an auditor was originally appointed in 2004, then re-appointed on the basis of a tender in 2013, with the conclusion that the PIE would not have to tender again until 2023. However, it is not clear if the PIE can reappoint the same auditor in this example in 2023, as our interpretation is that the auditor would have to rotate due to the maximum 20 year duration being reached. Accordingly, we would appreciate BIS clarifying this point when it publishes its detailed guidance.

A service such as investor tax reporting should not be prohibited

Germany, the UK, Switzerland and Austria all require detailed per unit taxable income information to be provided to investors. This includes non-domestic funds registered for sale in these jurisdictions under EU passporting rights (e.g UCITS) or under equivalent Swiss legislation. If this is not done, the fund will not have tax status in that jurisdiction and the investors will pay excessive tax on their holding in the fund. This is a high volume activity - BlackRock provides well in excess of a million pieces of tax data per annum under these tax reporting regimes taken together.

Much of the calculation work is undertaken by fund administrators, but typically there is a very large process involvement by one of the Big 4 audit firms. Most fund managers choose to get a degree of independent tax compliance assurance over the figures, and further in Germany it is requirement of the tax regime that a licensed *steuerberater* (tax adviser) certifies the key tax disclosure figures. Owing to the highly operational, high volume nature of the process, moving between tax service providers requires lengthy planning.

We believe that services such as investor tax reporting should be permitted to be carried out by the audit firm or a member of its network. We are concerned that removing the possibility of using the fund auditor for this work will reduce choice and competition in this material, specialised tax services market to an unacceptable degree. Investor tax reporting has no direct or material impact on the financial statements of a PIE, nor does it involve any advice or element of discretion to the fund itself. Rather, the consumer of the service is the end investor, who uses the data to complete their tax return. Therefore, we would suggest that BIS clarify that investor tax reporting is not a prohibited service under this Legislation with reference to Article 5.3 of the Regulation.

Yours sincerely,

Colin McDonald
Director

Tom McGrath
Director

Responses to questions

General question on the draft clauses prepared to complement the discussion in Chapters 5, 6, 7, 8 and 12

Question 1
Do you agree with the approach the draft implementing regulations take given the Government's conclusions as set out in these chapters? Why?

PIE definition

We support the Government's conclusion not expand the definition of a PIE further and beyond the EU minimum requirement as we believe it would add unwarranted complexity and cost.

Broadening the scope of entities captured by the Directive

MiFiD investment firms, UCITS and AIFs (collective investment schemes) are regulated and governed under other legislation and regulation within the UK relating to requirements for an annual audit, appointment/dismissal of auditors, independence requirements and qualification/disqualification of auditors. We believe that simply broadening the application of the implementation of the 2006 Directive in Part 42 of the Companies Act to include these entities could potentially bring in competing legislation that these entities need to comply with. For example open-ended investment companies (OEICs), which can be either UCITS or AIFs, are not companies under the Companies Act as they are not trading entities, but rather corporate entities with their own facilitative legislation that has been drafted specifically with the needs of collective investment schemes in mind. In principle it would be preferable if consequential amendments are made directly to the Open-Ended Investment Companies Regulations for OEICs or to the Financial Services and Markets Act and FCA implementing rules for authorised unit trusts. We would recommend that BIS consult separately with HMT on how best to make amendments to the legislation and regulations which govern the operation of collective investment schemes.

The new UCITS and AIFMD depositary regime justifies the audit committee exemption

We support the audit committee exemption available for UCITS and AIFs in Article 39.3 (b) of the Directive as these funds are subject to a well-established regulatory regime and additional specific governance requirements such as the appointment of an independent depositary. In addition, we support the audit committee exemption in Article 39.3 (a) where the group audit committee is discharging the requirements that would be imposed on a Public Interest Entity's (PIE) own audit committee as this exemption avoids any duplication and expense that would occur in a situation which would lead a PIE having to create an audit committee in addition to one that already exists at the group level.

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Familiarisation costs

Question 5
In the consultation IA we have estimated the direct costs to PIEs of having to tender the audit engagement every 10 years. In our final analysis, we also plan to include an estimate of the additional costs that would be incurred by a new auditor that has to familiarise itself with the business of a new PIE client. We propose that the additional familiarisation cost to auditors engaged in a new audit could be estimated is an additional 10-30% of the cost of the audit in the first two years. Is this reasonable?

Whilst BlackRock are not comfortable providing an estimated cost associated with forced rotation, our view is that these costs could be significant. Further, we believe that auditor transition increases the risks associated with PIEs during the period when the auditors are still developing institutional knowledge. It is for these reasons that we support the 10 year extension permitted by the Regulation where a public tender has been undertaken. Requiring rotation after 10 years reduces the competitiveness of the tender process and results in additional start-up time and costs for new auditors, which reduces the savings and investment returns for Europe’s citizens and employers.