Institute and Faculty of Actuaries

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Leading the risk profession

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Dear Ms Woods

IFoA response to the FRC's Consultation Document: Proposed Revisions to the UK Corporate Governance Code

In January 2014, the Institute and Faculty of Actuaries (IFoA), in conjunction with the Institute of Risk Management, responded to the FRC's consultation on Risk Management, Internal Control and the Going Concern Basis of Accounting. At that time, we outlined our support for the work the FRC is doing to improve Boards' focus on risk management and the processes used to manage risks across the full spectrum of companies covered by the Director's Code.

In this response, we have concentrated on Section 3 of the consultation document, as this is where we believe our expertise adds most value.

The FRC should be aware that the IFoA's Risk Board has set up a Working Party to consider the issues that may arise for actuaries, and others, as a consequence of the FRC's work on the Corporate Governance Code. As well as being instrumental in the drafting of this response, this highly active working party are in the process of commissioning research into company preparedness for these changes and preparing other materials to support boards in the implementation of the proposals. The IFoA is keen to share the outputs from this working party with the FRC as they become available.

The IFoA hopes that this response is helpful to the FRC and that it will play a part in enabling the FRC to resolve remaining issues, so implementation can proceed in line with the proposed timetable. We remain confident that with the support of actuaries, and other risk professionals, boards will improve the transparency of their risk disclosures as a result of these proposals and that the benefits this will bring for investors are in the public interest.

General comments

The IFoA is supportive of high quality and proportionate risk management and viewed the proposals in the previous consultation as a major improvement in the guidance offered to directors. Overall, the IFoA remains very supportive of the proposed revisions to the Code and the associated guidance. The IFoA believes that good risk management processes are an important part of corporate governance and the additional statements that the FRC is asking directors to make will increase focus in this area.

Whilst remaining supportive of the FRC's objectives, we consider the latest consultation could give rise to practical difficulties for directors on the basis of the specific wording of the proposed revisions. In response to our concerns over the wording used in the most recently proposed changes to the

Code, we suggest some specific areas where amendments could be made to improve clarity and help to ensure that the Code achieves its intended purpose.

The proposals introduce material changes, relative to the existing version of the Code and to the November 2013 consultation. A key change from the previous consultation is the introduction of a new requirement in the Code (C.2.2) "*The directors should state whether they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment."* This would be in addition to the requirement in the Code (C.1.3) for a statement related to going concern.

We suggest that amendments could helpfully be made to the Code, to ensure that the differentiation between the requirements in C.1.3 and C.2.2 is sufficiently clear. The accompanying guidance will help those preparing statements to understand the intended differentiation, but further distinction between the relative expectations under each provision would be welcome. For example, if the FRC's intention was that C.1.3 remains focused on the immediate short term associated with a going concern statement, but that C.2.2 was intended to pick up the slightly longer term associated with the firm's normal planning horizon, it might be helpful to draw this out more explicitly in the guidance.

C.2.2 requires directors to *"state whether they have a <u>reasonable expectation</u> that the company will be able to continue in operation and meet its liabilities as they fall due over the period of the assessment".* In the absence of any definition to the contrary, we would expect most actuaries and other users of accounts to take 'reasonable expectation' to refer to a central expected view of the normal range of future outcomes, with the test being whether that central expectation is reasonable and justifiable. However, we also recognise that it is possible to interpret this as being a reasonably sure expectation, which might be considered more consistent with the degree of resilience associated with a going concern statement.

The draft guidance (page 32 of the Consultation Document) states, "*that the statement should be based on a robust assessment of the risks that would threaten the business model, future performance, solvency or liquidity of the company*". This implies the FRC is looking for a higher degree of confidence than C.2.2. suggests; i.e. that the company will be able to continue in operation in a wider range of circumstances, including many adverse ones, than would normally be associated with a 'reasonable expectation'. It will be necessary for directors to fully understand and then document the confidence level they believe should apply, before they will be able to prepare the statement. Whilst actuaries, and others, will be able to help boards consider the range of adverse scenarios they might judge to be reasonable and take into account there is a risk without further clarification from the FRC, boards will be tempted to "boilerplate" their statement with an extensive list of assumptions and caveats.

There are two directions the FRC could take to clarifying the guidance depending on the degree of prudence it intends directors to apply when making these statements;

1. The proposed Code Provision wording C.2.2 could be retained, but the guidance is updated to explain that this refers to a soundly justified central expectation that the business can continue as a going concern.
2. Revision to Code Provision wording C.2.2 to ensure the text better reflects the intent that companies remain viable under a wide range of scenarios. The FRC could also give a more explicit indication of the severity of events that they would expect firms to be able to survive. We recognise there is a difficult balance to be struck between giving boards sufficient guidance on what is required to focus their thinking and being overly prescriptive (and as a consequence disenfranchising the board). Overall, we would urge the FRC to give as much

clarity as possible to avoid the risk of "boilerplating". Where regulations (such as in financial services firms) already drive firms to consider a statistical modelling of outcomes, actuaries have helped boards develop these models and we consider many of the techniques could be relevant across a broad range of enterprises, whilst recognising not all firms will need to go as far as developing a statistical distribution of the possible outcomes.

Response to consultation questions

Question 5: Do you agree with the changes to the Code relating to principal risks monitoring the risk management system?

Yes, we agree with and support these changes.

Question 6: Do you agree that companies should make two separate statements? If so, does the proposed wording make the distinction between the two statements sufficiently clear?

As discussed above, we have concerns whether the current proposals provide sufficient clarity on what is required of companies. We consider it possible to construct requirements that will provide complementary information to the readers of accounts and would be happy to engage with the FRC in developing an appropriate approach.

Question 7: Do you agree with the way proposed Provision C.2.2 addresses the issues of the basis of assessment, the time period it covers and the degree of certainty attached?

As discussed above, we have concerns whether the proposed Provision is sufficiently clear, also the associated guidance does not appear to align well with the proposed wording of the provision.

Question 8: Do you have any comments on the draft guidance in Appendix B on the going concern basis of accounting / or the viability statement?

We support the 'going concern' basis of accounting guidance but, as noted above, we have concerns that the viability statement is inconsistent with the wording of the Provision C.2.2.

Question 9: Should the FRC provide further guidance on the location of the viability statement?

We consider that users of accounts would find it helpful if the 'viability statement' was located in a consistent position for all companies; as such further, guidance would be helpful.

Question 10: Should the recommendation that companies report on actions being taken to address significant failings or weaknesses be retained? If so, would further guidance be helpful?

We agree that this recommendation should be retained and that the existing guidance is sufficient.

Should the FRC wish to discuss any of the points raised in further detail please contact Paul Shelley (paul.shelley@actuaries.org.uk/ 07917604985) in the first instance.

Yours sincerely,

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