

13 August 2013

Inquiry Manager
Statutory Audit Investigation
Competition Commission
Victoria House
Southampton row
London
WC1B 4AD

Dear Sir,

Statutory audit services market investigation – Provisional decision on remedies

ICAP plc ('ICAP' or 'we') is providing comments, as invited by the Competition Commission ('CC' or 'you' or 'your') in its provisional decision on remedies report published on 22 July 2013 ('the report').

We support your decision not to pursue certain strenuous remedies which were initially proposed in the Remedies Notice published on 22 February 2013; in particular, the mandatory rotation of auditors every five years.

We understand that the key purposes of the provisional remedies are to prevent or mitigate adverse effects on competition ('AEC') in the UK audit market and mitigate resulting customer detriments. We share your view that shareholders and FTSE 350 companies will be better served by a more competitive market for statutory audit – mostly in respect of more competitive audit fees.

However, we believe that the provisional remedies that you set out will largely fail in their attempt to create a more competitive audit market for FTSE 350 companies. Your provisional recommendations fail to address the significant difference in capacity and global footprint between the Big 4 and most of the other audit firms, which we consider the main reason for the lack of switching. To audit most multinational FTSE 350 companies, the audit firms need to be appropriately resourced to carry out a group audit across multiple countries and functions. Most of the non-Big-4 firms are simply not sufficiently equipped to do so. We agree with the Financial Reporting Council's ('FRC') view that mandatory tendering will not guarantee reduced concentration and, in fact, concentration might increase as non-Big-4 firms find their existing audits put out to tender. We believe that there is a great risk that frequent tenders would prove to become simply theoretical, hence the only outcome will be increased costs and disruptive effect on businesses, the exact opposite of what you were trying to achieve with the proposed remedy.

As noted above, with most non-Big-4 firms lacking sufficient capacity and global footprint to audit a FTSE 350 multinational company, a tender process will be effectively restricted to the Big-4 firms. However, the options available to FTSE 350 companies could be further limited when varying levels of skills and experience among the Big-4 firms in certain sectors are considered. We believe that mandatory tendering therefore may lead to a forced selection when the choice is limited to only one or two firms; especially when conflicts arising from outsourced internal audit and other mandates are taken into account together with a presumption that tender should not result in the incumbent auditor being selected. Additionally, such forced selection may result in poorer services as the new auditor may already have significant sector coverage, hence the best audit team may not be

available to the shareholders. Whilst we are supportive of the general trust of the FRC towards a ten year review and a comply or explain basis, we are concerned that a move to a shorter mandatory basis could lead to a tendering process which would prove to be a case of form over substance.

We recognise the importance of a high standard audit, which contributes to effective corporate governance and the efficient operation of financial markets, including debt and equity markets. ICAP's Audit Committee ('AC') is well informed when annually assessing the performance of ICAP's external auditors as they have the experience of working with other accountancy firms. In doing so, the ACs protect shareholders' interest in obtaining comfort from the audit report that the financial statements are true and fair.

In the following pages (pages 3 -5), we set out our views on each of the provisional remedies, but it is worth highlighting that we have serious reservations about the five year mandatory tendering proposal, which we believe can be significantly detrimental to shareholders. We believe that such frequent mandatory tendering cycle will result in increased costs for companies, compromises shareholders' rights, and possibly more importantly, will lead to a loss of audit quality. The latter may adversely impact the effectiveness of the assurance provided to the shareholders as to the truth and fairness of the financial statements.

We echo FRC's scepticism and support its view that its balanced and sensible 10 year tendering cycle (on a comply or explain basis) should be given the opportunity to prove itself, not least because it was introduced into the Corporate Governance Code ('the Code') only last year.

If you wish to discuss ICAP's views contained within this letter, please do not hesitate to contact me.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'John Sievwright', written in a cursive style.

p.p. John Sievwright
Audit Committee Chairman
ICAP plc

ICAP's views on CC's provisional decision on remedies (detailed recommendations by CC are listed in the boxes)

CC remedy 1: Mandatory tendering

- FTSE 350 companies should put their statutory audit engagement out to tender at least every five years. Companies may defer this obligation for up to two years in exceptional circumstances. The reasons must on each occasion be set out in the audit committee report. Companies must go out to tender by the end of year 7. This compares with the current FRC provisions that require companies to go out to tender every ten years on a 'comply or explain' basis with no limit specified on the number of years that a company could opt to 'explain'.
- Companies have the right to require the incumbent audit firm give them access to specified elements of the audit file for disclosure to rival bidders in a tender process.
- Companies must monitor and certify compliance with the provisions of the Order in the audit committee report.
- The FRC to amend the UK corporate governance code in line with the provisions of this proposed Order.

ICAP's view:

ICAP favours the current FRC provisions, as we consider that the option of whether to tender is a cost/benefit decision (with a significant weight placed on contribution to corporate governance) for the AC and the shareholders, and should not be mandatory. ICAP believes that the Code recommendation for the AC to assess the effectiveness and the performance of the external auditor on an annual basis forms an effective tool for ensuring audit quality, particularly when coupled with an affirmative recommendation formed by the AC whether to put the audit engagement out for tender or not. Additionally, ICAP's AC value auditors' ability to robustly challenge the management, which is possible only when there is a deep understanding of the business built through years of specific experience of the company. Therefore, in case of a new auditor, there is always a greater risk of compromise of audit quality and the effectiveness of the assurance that is being provided to shareholders as to the truth and fairness of the financial statements.

Like many FTSE 350 multinational companies, our scale and geographical spread mean that tendering will impose a sizeable cost burden on shareholders as each region and function would need to be involved in the tendering process. Additionally, the tender process will result in additional costs for the audit firms, which would likely result in them passing those costs on to their clients. This dual impact would result in additional burden on companies, which competitors in other jurisdictions would not face, hence resulting in detriments to the UK companies.

In paragraph 3.148 of the report, the CC noted that the FRC determined a ten-year tendering cycle on comply or explain basis in a different context to that of a competition investigation. ICAP recognises the different context in which FRC and CC determined a suitable tendering cycle. However, it is unlikely that more frequent tendering than that suggested by the FRC will break the dominance of Big 4 in the UK audit market for FTSE 350 companies. Most non – Big -4 firms would not have the experience, capacity or global footprint to audit the widespread and complex operations of most multinational FTSE 350 companies. ICAP considers that only the Big-4 are capable of successfully carrying out its Group audit, therefore most non-Big-4 firms may not have the opportunity to tender for the audit work even in the mandatory five year tendering cycle. A five year mandatory tendering cycle is therefore unlikely to enhance competition in the UK audit market.

Additionally, we believe the current requirements for a five-year rotation period for audit engagement partners in listed companies' audits and no involvement in the engagement for at least five years afterwards aligns well with a ten-year tendering cycle as recommended in the Code. The provisions help ACs and shareholders consider possible threats from familiarity risks of an audit engagement partner returning after the five-year cooling off period.

CC remedy 2: Audit quality review

- The FRC is recommended that the controls, systems and processes of each of the 'major firms' identified by the FRC (those which have ten or more audit clients in the AQR team's scope) should be reviewed and reported with equal frequency.
- The FRC is recommended that the AQR team should review every audit engagement in the FTSE 350 on average every five years, with each individual audit engagement in the FTSE 350 reviewed at least every seven years.

ICAP's view:

ICAP supports this proposed remedy. Greater availability of AQR reviews for the FTSE 350 subset would provide a useful benchmark for the ICAP AC to assess the incumbent external auditor's performance. This will also assist shareholders in making an informed decision to appoint or remove auditors.

CC remedy 3: Auditor clauses in loan agreements

- prohibit provisions in loan agreements which restrict or have the effect of restricting a company's choice of auditor to certain categories or lists of statutory auditors:
 - by company, we mean any company whose annual accounts for a financial year must be audited in accordance with Part 16 of the Companies Act 2006;
 - by loan agreements we mean any arrangement between such a company and one or more providers of debt capital for the purposes of providing borrowing facilities to that company. This includes bi-lateral and syndicated agreements and public prospectuses in relation to bond issues;
 - the prohibition will apply to the relevant provision(s) but does not affect the validity of the rest of the loan agreement;
 - the prohibition will not apply to loan agreements currently in force;
 - companies must monitor and certify compliance with the Order in their Annual Report; and
- a recommendation to the Loan Market Association that it amend the auditor clause in its template leveraged loan documentation in line with the provisions of the proposed Order.

ICAP's view:

ICAP supports this proposed remedy in its entirety. As noted by the CC, any such prohibition must not apply to the loan agreements currently in force.

CC remedy 4: Enhanced shareholder engagement

- The FRC is recommended to amend the UK Corporate Governance Code by introducing a specific obligation on companies with a Premium Listing: (i) to engage with shareholders through seeking shareholder views on audit issues and stating how any shareholder concerns identified as a result may have been addressed; and (ii) to introduce an advisory vote for shareholders on the sufficiency of disclosure in the Audit Committee Report.
- The FRC is recommended to update the Stewardship Code to encourage institutional investors to engage with investee companies on audit issues, through monitoring investee companies and escalating stewardship activities.

ICAP's view:

Whilst we support the remedy in principle, we are not convinced on the effectiveness of this measure. The FRC's response in paragraph 3.321 of the report noted that similar proposals in the past received a largely negative response from investors and other market participants and that significant time commitment from investors could not be relied upon.

CC remedy 5: Strengthening the accountability of the external auditor

- For a FTSE 350 company, only the AC acting collectively or through the ACC is permitted to:
 - negotiate and agree audit fees and the scope of audit work;
 - initiate and supervise a tender process for external audit work and make recommendations for appointment of auditors following a tender process;
 - require replacement of an AEP; and
 - authorize the external audit firm to carry out any NAS.
- Further, the auditor should report any audit issue that the AEP considers to be material as soon as is practicable to the AC or ACC, having established the facts of the issue with finance or other relevant company staff.
- CC intends that companies monitor and certify compliance with the Order in the Audit Committee Report.

ICAP's view:

We believe that with this remedy, the CC may have understated the extent to which external auditors are already accountable to ACs in FTSE 350 companies. ICAP AC spent numerous working days focussing on the Group's audit-related work in the 2012/13 financial year. As well as dealing with issues as they arise, the AC meets at least twice a year with the Group's external auditors and Head of Internal Audit without any executive directors or members of management present. At ICAP the AEP already escalates material issues as soon as practicable to the AC. We believe that this is the practice elsewhere in FTSE 350 companies as well; hence CC's point around escalating material issues to the AC does not change anything.

We agree with the majority of the recommendations above, and indeed follow them in practice. However, we do not believe that the AC is the right body to negotiate and agree audit fees, but the AC is the appropriate body to challenge and approve audit fees. Responsibility for negotiation and agreement of fees will mean that the AC will implicitly assume an executive role; hence challenging the underlying principle of corporate governance framework. Such a role with focus on costs may compromise AC's objective of making sure a full scope audit is performed.

Additionally, ICAP considers it appropriate that senior financial management also have influence over the decision to appoint or reappoint the auditor. External auditors must be able to work constructively and effectively with senior financial managers in the course of auditing the company. It would therefore be difficult, if not impossible, to appropriately assess auditor performance without input from financial management to the AC.

CC remedy 6: Extended reporting requirements – in both the AC's and auditor's report

- FRC is recommended to amend the UK Corporate Governance Code to include an additional provision. The disclosure of AC's effectiveness of the auditor in the Audit Committee Report to disclose (i) whether the AQR team has concluded a review on the audit of the company's financial statements in the reporting period, (ii) what the principal findings were, including grade, and (iii) how both the AC and auditor are responding to these findings.

ICAP's view:

ICAP believes that the scope of disclosures and whether the Annual Report is the correct place for such disclosure needs further deliberation. We believe that there is a risk that such disclosures can be misinterpreted by market participants and can unfairly bring the quality of financial statements and directors' stewardship in dispute. As such, we do not support this remedy.

CC remedy 7: Competition objective for the FRC

ICAP's view:

No comment as we believe the FRC is the most appropriate body to respond on this.