

# Standard Life Investments

Inquiry Manager  
Audit Market Investigation  
Competition Commission  
Victoria House  
Southampton Row  
London  
WC1B 4AD

**Standard Life Investments**  
1 George Street  
Edinburgh  
EH2 2LL  
**phone: 0131 245 7956**  
**fax: 0131 245 5138**  
email: [mike\\_everett@standardlife.com](mailto:mike_everett@standardlife.com)  
[www.standardlifeinvestments.com](http://www.standardlifeinvestments.com)

9 August 2013

Dear Sir or Madam,

## **Audit Market Investigation**

Standard Life plc is listed on the London Stock Exchange and has approximately 1.3m shareholders in over 50 countries around the world. Established in 1825, Standard Life is a leading provider of long term savings and investments to around 6m customers worldwide. Headquartered in Edinburgh, Standard Life has around 8,500 employees internationally.

The Standard Life group includes savings and investments businesses, which operate across the UK, Canada, Europe, Asia and Middle East; workplace pensions and benefits businesses in the UK and Canada; Standard Life Investments, a global investment manager, which manages £179bn globally; and its Chinese and Indian joint venture businesses. At the end of March 2013, the Group had total assets under administration of over £233bn.

We welcome the opportunity to respond to the Competition Commission's proposed remedies for the audit market and to contribute to this important debate. We have attached our views on each of the proposed remedies as defined in your provisional decision document. We have considered the proposals both from the point of view of Standard Life plc, as a FTSE100 company, and Standard Life Investments ("SLI") as a major investor with a particular focus on governance and stewardship matters, including accounting and audit standards. Whilst we are supportive of some of the proposed remedies, we have concerns that some could have a detrimental impact on the audit market and audit quality. Therefore, we would request that the Commission reconsiders several of them in the light of comments received.

Standard Life is aware of the movement for change in areas such as the audit market as one means to help restore trust in business generally, and more specifically financial services. We are therefore mindful that changes to the audit market structure, and improvements in the quality of audits and audit reports, are required and expected. SLI have publicised their position in a number of letters and feedback statements to various legislative bodies including the Financial Reporting Council ("FRC") and the European Commission and are supportive of the need for change. Standard Life plc has recognised the relevant 2012 changes to the UK Corporate Governance Code and the Guidance on Audit Committees and taken steps to reflect them in the terms of reference and operational and reporting activities of its Audit Committee.

We have been supportive of the changes made by the FRC to the Corporate Governance and Stewardship Codes as an issuer and an investor. SLI engage with investee companies on various topics, with auditor tendering and rotation a key topic over the recent past. The willingness of audit committee chairs to meet

Standard Life Investments Limited is registered in Scotland (SC123321) at 1 George Street, Edinburgh EH2 2LL.  
The Standard Life Investments group includes Standard Life Investments (Mutual Funds) Limited, SLTM Limited, Standard Life Investments (Corporate Funds) Limited, SL Capital Partners LLP and AIDA Capital Limited.  
Standard Life Investments Limited is authorised and regulated by the Financial Services Authority.  
Calls may be monitored and/or recorded to protect both you and us and help with our training.  
[www.standardlifeinvestments.com](http://www.standardlifeinvestments.com)



with shareholders has been noticeable and it is felt that the FRC Code changes are having an impact on the focus on the audit service and there is evidence that the number of audit tenders is increasing.

The views we have provided are tempered by our thoughts that, within SLI's stewardship and engagement activities, we are already seeing improvements and that generally we would like to see the existing regulatory framework be given time to work. The bullet points below provide our high level comments on the proposals, and our detailed comments on each proposal are attached in the accompanying appendix:

- We believe that a mandatory tendering process every five years is excessive and may result in increased risk of audit failure and less market choice. We do not believe that it is in the clear interest of companies, shareholders or auditors. Indeed we have concerns that the increased level of tenders may benefit the bigger audit firms who have the resources to be able to handle an increased level of tendering.
- We note that the Competition Commission have chosen not to recognise the cost estimates for tendering activity provided by some of the audit firms and have provided their own estimated cost of approximately £30m. We are concerned that this estimate may be too low when considering all of the costs resulting from the proposed remedies. We are also concerned at the significant cost in terms of management time which will be required by the firms engaging auditors.
- We have reservations as to whether a number of the provisions will deliver improved competition. It would appear that a number of the proposals are designed to deliver reduced cost audits rather than higher quality audits;
- It will take time for the effect of the FRC's 2012 Code changes, which included a 10 year tender period to be implemented on a "comply or explain" basis, to be seen. The FRC are required to follow a strict process of consultation when making changes to their Codes. Rather than have regular introduction of proposals for additional changes we would prefer to see a period of stability to assess the impact of changes. Should it be felt that, after an appropriate period of assessment, the required outcomes are not being delivered then a further consultation process may be needed.

We hope that you will take these comments in the constructive manner in which they are intended. We acknowledge that change is required in this area and believe that the FRC's amendments to their Corporate Governance and Stewardship Codes are having the desired impact. We are concerned that the more restrictive proposals put forward by the Competition Commission could have a detrimental impact on progress and may lead to negative consequences.

Yours faithfully



Mike Everett  
*Governance and Stewardship Director*  
*Standard Life Investments*



## Appendix

### **1. Mandatory Tendering**

We do not support the proposed remedy to require the mandatory tendering of the audit service every 5 years. We remain supportive of the FRC's 2012 10 year tendering cycle on a 'comply or explain' basis as we believe it strikes the right balance of improving competition in the market, the delivery of quality audits and efficiency for the audit client. We think that the pressures of increased tenders on the resources of audit firms significantly heighten the risk of audit failure. We are concerned that in the current focused market a failure of an audit firm could bring significant systemic risk and therefore are not supportive of measures that we believe could increase the risk of failure.

The Competition Commission's own research indicates that the general view is that most companies will "comply" with the FRC's requirements rather than "explain" and the results of this should be given time to become apparent.

We note from the Competition Commission's paper on the proposed remedies that it disregards the estimated costs of increased tendering provided by audit firms. However we would be concerned that mid-tier firms are more likely to be unable to bear the costs of increased tenders and therefore in our view this remedy is unlikely to increase the level of opportunities for mid-tier firms and may indeed be beneficial to the larger 'Big 4' firms.

### **2. Audit Quality Review ("AQR")**

The AQR reports are designed to allow an assessment of the quality of each of the audit firms and so we are supportive of the proposal that there should be an annual review and report on all firms under the scope of AQR. We believe that this will be an additional incentive to the firms to maintain high standards of audit quality.

We are also supportive of the proposal for Audit Committees to report significant AQR findings to shareholders, but we would note that, in the experience of the SLI governance and stewardship team, this already occurs.

We are however concerned about the impact of the increase of frequency of reviews to a level of once in every 5 years for FTSE 350 companies. We would therefore be keen to ensure that the increased number of reviews does not impact on the scope and quality of the AQRs.

### **3. Auditor Clauses in Loan Agreements**

We agree with the proposal to prohibit the use of 'Big 4' only clauses in loan agreements as we believe that these can have the impact of limiting the choice of auditors available to a company.

### **4. Enhanced Shareholder Engagement**

We agree with the desired outcome of increased engagement between companies and key institutional investors on audit matters and made this clear in our response to the FRC's consultation on their 2012 amendments. Although the Stewardship Code amendments in 2012 did not explicitly include a principle encouraging engagement on audit matters, we feel that there is evidence of increased engagement since the publication of the amended Code and we would welcome a further period of stability to assess if these improvements continue.

We are uncertain whether the proposal for shareholders to have an advisory vote to approve the audit committee report would increase competition as envisaged. We believe that the existing shareholder annual vote on the re-election of auditors is sufficient at the moment. It may be appropriate that shareholders have the opportunity to have an advisory vote on the Corporate Governance Report as a whole, rather than just the audit committee report, but this could be revisited in due course once the effect of the 2012 Code changes begins to be seen.

## **5. Strengthening the Accountability of the External Auditor**

As indicated in the research of the Competition Commission, we have seen improvements in the operation and activities of Audit Committees since the publication of the Corporate Governance Code amendments in September 2012. We therefore believe that further time should be given to allow the code to bed in rather than impose additional requirements for change. When assessed with the proposals in Remedy 4 above we would suggest that the increased engagement on audit issues will continue to increase the accountability of Audit Committees for their role in managing the relationship with the external auditor.

## **6. Extended Reporting Requirements—in both the Audit Committee’s and Auditor’s Report**

We agree with the proposed amendments. We would however highlight, as noted in our feedback to remedy 2 that, in our experience, Audit Committees have provided reporting on the AQR findings relevant to them. These additional reporting requirements could be linked to the amendments proposed in remedy 4 in relation to enhanced shareholder engagement on audit issues.

## **7. Competition Objective for the FRC**

Although we agree with the Competition Commission's stated objective to increase quality and innovation in the statutory audit market through the inclusion of a competition objective for the FRC our view is that should any change be made to the FRC's articles it should focus on the quality outcome. We believe that the FRC should have regard for ensuring that audit quality is maintained to a high standard whilst noting that a lack of choice could impact adversely on maintaining such high quality standards. It would therefore be preferable for amendments to bring further focus on quality and the impact of choice on this rather than focusing on competition in order to drive quality.