

FRC Bills Committee
Legislative Council
Central
Hong Kong

Hugo Chiu
Senior Council Secretary of the Legislative Council
Via email: hytchiu@legco.gov.hk

16 March 2018

Dear Sir,

USS Submission on Financial Reporting Council (Amendment) Bill 2018

USS Investment Management welcomes the opportunity to respond to the HK Financial Reporting Council (Amendment) Bill 2018 and the proposal to allow the Financial Reporting Council (FRC) to become an independent oversight body regulating auditors of listed entities which are regarded as public interest entities (PIE), and be responsible for the inspection, investigation and disciplinary functions with regard to PIE auditors.

By way of background, Universities Superannuation Scheme (USS) is one of the largest pension schemes in the UK, with total fund assets of over £60 billion. The scheme's trustee is Universities Superannuation Scheme Ltd, a corporate trustee which provides scheme management and trusteeship. USS Investment Management Ltd (a wholly owned subsidiary of Universities Superannuation Scheme Ltd) is the principal investment manager and advisor to the scheme.

As an institutional investor that takes seriously its fiduciary obligations, USS aims to be an active, engaged and responsible owner of the companies and assets in which it invests. We devote substantial resources to implementing an active approach towards stewardship, an approach which the trustee company expects both to protect and enhance the value of the scheme's investments in the long-term.

USS, on behalf of its members, invests significant capital in HK-based companies. USS Investment Management is reliant upon the quality of financial statements and financial reporting. We consider independent oversight and regulation of: the standards in professional ethics, auditing and assurance; and continuing professional development requirements, of the audit firms (and individual auditors) as critical to the level of confidence our investment professionals place in investing in Hong Kong. USS is a member of the Asian Corporate Governance Association (ACGA) and kindly request you review their submission also.

Whilst we welcome the enhancement of the FRC's role as the independent regulatory entity for external auditors of listed companies in Hong Kong, we raise the following observations and concerns;

1. Adequate funding

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Whilst we broadly support the proposed funding model through new levies on transactions and market participants, USS suggests that the FRC undertakes a benchmarking exercise across public bodies in the various jurisdictions to determine the appropriate level of funding to ensure it can effectively fulfill its legislative purpose.

2. FRC Governing Body

For the purpose of allowing the regulator to properly supervise the overseas auditors of any overseas corporation or collective investment scheme listed in Hong Kong, we encourage the HK FRC to align with the requirements set by the European Union (EU) directive (2016). The directive states, inter alia, that all members of an independent audit regulatory governing body should be non-practitioners but experienced in audit and accounting. This alignment would most likely satisfy EU standards, remain in keeping with the spirit of strengthening accounting and audit expertise on the governing body and, provide international investors with greater confidence in implementation and oversight of accounting and audit standards.

3. Independent Non-Executives at the audit & accounting firms

Perhaps beyond the scope of this Bill, USS encourage the FRC to consider adopting the UK approach to audit firm governance by implementing the requirement for a Board of Independent Non-Executives (INEs). The Board of INEs sits "above" the accounting and audit firm Board, which is (normally) comprised of practicing (executive) partners of the firm. The purpose of the INEs is to give increased confidence to the market that the systemically-important audit and accounting firms adequately address matters such as conflict of interest, succession of the executive, ethics and, issues related to the public interest.

4. Scope of Public Interest Entities

We believe limiting the scope of regulatory jurisdiction (per Clause 77) of the FRC may lead to confusion, regulatory arbitrage between market participants and, diminish confidence in the regulatory environment. Out of regulatory scope include the duties assigned to auditors under the Listing Rules, such as reporting on any continuing connected transactions each year (Rule 14A.56), reviews of profit forecasts (Rule 14.62) and major transactions (Rule 14.67). USS kindly requests these aspects are recognized under the auspices of the FRC.

5. Standard Setting

USS believes the endorsement or adoption process of accounting (and auditing) frameworks and standards should be separate to and independent of the body that reviews and recommends said frameworks and standards. We encourage Hong Kong to strengthen the independence between endorsement and review of auditing and accounting standards.

We trust the above comments are helpful and look forward to the Legislative Council hearing.

Yours faithfully,



Elizabeth Fernando
Head of Equities