Financial Reporting Council

Levy Proposals 2007/08

March 2007

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One - Introduction

The FRC is the United Kingdom's independent regulator for corporate reporting and governance. Our aim is to promote confidence in corporate reporting and governance. We see confidence in corporate reporting and governance as vital to the healthy functioning of business and markets and underpinning wealth creation.

This document explains our proposals for our funding arrangements for 2007/08, specifically:

- our business levy in relation to our responsibilities for accounting, auditing and corporate governance
- our levies on insurance companies and pension schemes in relation to our responsibilities for actuarial standards and regulation.

We are also consulting on the principle of extending our business levy for 2008/09 and future years to include a wider range of publicly traded companies, such as those on AIM and PLUS Markets, which are within the scope of most of our regulatory responsibilities but which do not currently contribute to our costs.

Responses to the proposals are invited by 11 May 2007. We will aim to publish our final rates in June 2007.

In December 2006 we published details of our priorities for 2007/08, and the costs we expect to incur, in our Draft Updated Regulatory Strategy and Plan & Budget 2007/08 (http://www.frc.org.uk/about/), inviting comments by February 2007. It included a draft Strategic Framework for the FRC identifying the outcomes and other elements we believe contribute to confidence in corporate reporting and governance in the UK. The activities and projects we propose to undertake in 2007/08 are derived from our Strategic Framework.

Background

The functions we exercise can be summarised as follows:

- promoting high standards of corporate governance
- setting, monitoring and enforcing accounting and auditing standards
- setting actuarial standards
- statutory oversight and regulation of auditors
- operating an independent investigation and discipline scheme for public interest cases
- overseeing the regulatory activities of the professional accountancy and actuarial bodies.

Our functions are exercised principally by our operating bodies (the Accounting Standards Board, the Auditing Practices Board, the Board for Actuarial Standards, the Professional Oversight Board, the Financial Reporting Review Panel and the Accountancy Investigation and Discipline Board) and by the Council. The Committee on Corporate Governance, whose members are drawn from the Council, assists it in its work on corporate governance.

Some of our functions are supported by statutory powers, or by statutory obligations on other parties to meet our requirements - ‘’quasi-statutory’’ powers. Some of our functions have no statutory backing but derive their authority from widespread support from our stakeholders.

The primary basis for our responsibilities relating to accounting and auditing is the UK Companies Acts and is relevant to companies incorporated in the UK. We also have certain responsibilities for non-UK companies which are derived from European Directives. Our responsibilities for corporate governance relate to companies with a primary listing in the UK.

From April 2006, at the request of HM Treasury, we assumed responsibility for actuarial standards and regulation as recommended by the Review of the Actuarial Profession conducted by Sir Derek Morris. We set technical standards for actuaries advising insurance companies and pension schemes in statutorily reserved roles, and for other aspects of their work, and oversee the regulatory activities of the actuarial profession in relation to the professionalism and conduct of its members.

We are a non-profit making organisation. Our intention in raising funds in relation to all our activities is merely to recover our costs and to ensure that we have an appropriate level of reserves.

Our Financial Management and Reporting Framework (set out in our Regulatory Strategy) provides the framework within which we manage and report on the costs of our activities and how they are funded. While we endeavour to secure value for money in all our expenditure, we believe that the cost of our core operating activities is the best indicator of our effectiveness in managing our costs.

Two – Business levy 2007/08

Funding our responsibilities for accounting, auditing and corporate governance

Under the current arrangements, our core operating costs in relation to accounting, auditing and corporate governance are funded in equal proportions by the accountancy profession, the business community and the government. This is known as the tri-partite funding arrangement. Certain other costs (eg of audit inspection, and case costs relating to the investigation and discipline of accountants) are funded entirely by the accountancy profession.

The business community's share of our operating costs is raised by means of an annual business levy which is collected on our behalf by the Financial Services Authority (FSA) at the same time as the FSA invoices listed companies for their Listing Fees. This arrangement means that the incremental cost of collecting our levy is very low. We, not the FSA, are accountable for the amount of the levy and the amount of our levy is shown separately on the invoices.

It is our intention to continue to raise our business levy on a non-statutory basis based on the widespread support in the business, investor and professional communities for our work. The non-statutory arrangements have worked successfully and flexibly since 1990. There is provision in the Companies Acts for the Department of Trade & Industry (DTI) to make our levy a statutory charge. It is not the desire of either the FRC or the DTI to invoke those powers.

Summary of proposals for 2007/08

Our intention is that the core features of our existing arrangements for the business levy should continue in 2007/08. However, we propose that the arrangements be developed in two respects:

- With the agreement of HM Treasury, the DTI and the FSA, we will take on, from 2008, responsibility for collecting the UK contribution to the International Accounting Standards Board (IASB). The new arrangements, under which all listed companies will pay a small contribution (averaging £550), replace the current informal arrangements under which a small number of UK companies pay substantial amounts.
- Our levy is to be extended to overseas (other than EEA) companies with a secondary listing in the UK to reflect our additional responsibilities arising from the EU Auditing and Transparency Directives.

Amount of the business levy for 2007/08

The total amount we are seeking to collect for 2007/08 is as follows:

	£m
The business community's share of our core operating costs for 2007/08	3.6
less higher than expected collections in 2006/07	(0.2)
plus higher than expected costs in 2006/07	0.1
FRC funding requirement	**3.5**
plus the UK contribution to the funding of the IASB	0.7
Total business levy	**4.2**

FRC funding requirement

The FRC funding requirement of £3.5m compares to £3.1m in 2006/07. The budget for core operating costs for 2007/08 in relation to our responsibilities for accounting, auditing and corporate governance is £10.9m, compared with £10.2m in 2006/07. The increase reflects additional work as a result of the Transparency Directive, international aspects of audit regulation (including the 8th European Company Law (Auditing) Directive), and the application of the Freedom of Information Act to our Professional Oversight Board. The business community's share of these costs is £3.6m.

Actual receipts in relation to the business levy exceeded estimated receipts by £0.2m in 2006/07. We will use those receipts to reduce the amount of the business levy in for 2007/08.

Our costs in 2006/07 are likely to be a little higher than expected. This is due entirely to the award of £1.0m costs against our Accountancy Investigation and Discipline Board in respect of the Mayflower case. We expect to absorb around 70% of these costs from other savings compared to the 2006/07 budget but, given that our reserves are only approximately £1m, we propose to recover the balance in 2007/08.

UK contribution to the funding of the International Accounting Standards Board

Significant aspects of the regulatory environment for corporate reporting and governance are now decided or heavily influenced by European or global organisations – including the International Accounting Standards Board (IASB) which is responsible for issuing International Financial Reporting Standards (IFRS). We attach great importance to our efforts to influence, the work of the IASB in developing standards that contribute to international confidence in corporate reporting and governance, are proportionate, and do not impose unnecessary burdens.

There is widespread international recognition that the current arrangements for funding the IASB are unsatisfactory and unsustainable. These arrangements rely on contributions from a relatively small number of companies, audit firms, central banks and other organisations. They expire at the end of 2007. The Trustees of the Foundation which oversees the IASB and which is responsible for its funding have decided to put in place new and more satisfactory arrangements. The Finance Ministers of the European Union have indicated their support for the Trustees' efforts and have confirmed that the funding should come from the private sector.

The Trustees have determined that the appropriate funding requirement for the IASB from 2008 should be £16m per annum. The major international accounting firms and certain global organisations have agreed to contribute around £4m in total. The Trustees have decided that the remainder of the budget (around £12m in total) will be allocated to geographic regions according to GDP, subject to minor adjustments to permit lower contributions from developing countries. This basis of allocation is expected to result in a request for a UK contribution of £0.7m. The Trustees have left it to individual countries to determine the national arrangements for collecting the amounts required from the private sector. Further details of the Trustees' funding proposals are available on the IASB website.

With the agreement of HM Treasury, the DTI and the FSA, it is our intention that we should take the lead on behalf of the UK business community in raising the UK contribution to the cost of the IASB for 2008 and future years. The work of the IASB falls directly within the scope of the FRC's national responsibilities. Our Accounting Standards Board plays an active role in the development of international accounting standards and the timing and extent of the convergence of UK standards with international standards. Our Financial Reporting Review Panel is responsible for monitoring and enforcing international standards in the UK.

The expected UK contribution is small relative to the size of the UK economy and, therefore, we believe that we should adopt a simple, low cost mechanism for recovering it. We believe that the most appropriate mechanism is to add it to the business community's share of the FRC's costs. We estimate that the average contribution per company will be £550, with the cost for individual companies depending on their market capitalisation.

The UK contribution to the IASB has not been included within the FRC's tripartite funding arrangements. That would have resulted in a contribution from public funds, which the government does not regard as appropriate, and from the accountancy profession, which is already contributing to the IASB through the funds provided by the major accounting firms.

Consultation question:

1. **Is it appropriate for the FRC to raise the UK contribution to the proposed new funding arrangement for the IASB by adding it to the business levy?**

The scope of the business levy for 2007/08

We are proposing that an additional category of companies, non-EEA overseas companies with a secondary listing of ordinary shares on the London Stock Exchange's Main Market, should contribute to the business levy in 2007/08.

Overseas companies with a secondary listing on the UK Main Market

The Companies (Audit, Investigations and Community Enterprise) Act 2004 resulted in overseas companies with a primary listing of equity shares in the UK coming within the scope of our activities and we brought them within the scope of the levy at that time. The EU Transparency Directive and the 8^{th} European Company Law (Auditing) Directive have now resulted in us having responsibilities in relation to additional categories of overseas companies.

The EU Transparency Directive imposes minimum requirements on the information to be provided to the public about issuers whose securities are traded on a regulated market. Most of the responsibility for the implementation of the Transparency Directive rests with the FSA. But our Financial Reporting Review Panel is responsible for monitoring compliance with those aspects of the Transparency Directive relevant to financial reporting for all companies with securities admitted to trading on a regulated market in the UK which are required to produce such reports.

In addition, the implementation of the 8^{th} European Company Law (Auditing) Directive will require the FRC's Professional Oversight Board (POB) to regulate the auditors of non-EEA companies with securities admitted to trading on a UK regulated market. This is likely to involve the registration of all such audit firms and, where the non-EEA country does not have an equivalent system of audit regulation, the periodic inspection of the audit firm. During 2007/08, the POB will undertake a programme of work to prepare for the implementation of the new arrangements, which will come into force in June 2008.

In the light of the range of new responsibilities which we will be undertaking, or preparing to undertake, in 2007/08, it is, therefore, our intention to extend the scope of our business levy to all overseas companies with a listing of ordinary shares on the London Stock Exchange's Main Market, with the exception of EEA companies which will be subject to the regulatory arrangements applied by their home competent authorities. We propose to give overseas companies with a secondary listing a 50% discount on the levy, in line with the discount already provided to overseas companies with a primary listing of shares.

We are not proposing at this stage to extend the business levy to cover other securities (eg Depositary Receipt issuers), but will keep this issue under review for 2008/09 and future years once the scope of our responsibilities under the Transparency Directive and 8th European Company Law (Auditing) Directive is finalised.

We are also aware that the FSA is considering a number of changes to the listing rules relating to overseas companies. We shall consider the impact of the FSA's decisions on our levy for 2008/09 and subsequent years.

Consultation question

2. **Do you agree with our proposal that the business levy should be extended to non-EEA overseas companies with a secondary listing of ordinary shares on the London Stock Exchange's Main Market?**

Proposed levy rates for 2007/08

The key features of the levy are:

- a minimum levy
- further amounts payable by companies above a certain market capitalisation, with the rate per £m of market capitalisation declining in five levy size bands.

The minimum levy and the rates for larger companies are calculated based on the number of listed companies and their market capitalisations as at 30 November in the year preceding the year to which the levy relates (ie the levy for 2007/08 will be based on data as at 30 November 2006). This date is the one on which the LSE and the FSA base their fees; adopting this date avoids the need for additional data collection and inconsistency with their fee calculations.

The amounts payable by companies of any given size will be determined by the decisions on:

- the amount of the minimum levy
- the size limit for companies to which only the minimum levy applies
- the speed at which the rates payable by larger companies decline.

In the period between November 2005 and November 2006 there has been a significant increase in the market capitalisation of listed companies.

The final rates which will apply for 2007/08 can only be determined after May 2007, when the number of companies which will be liable to pay the levy is finalised. To allow companies to estimate the likely amount of the levy we have calculated provisional rates as follows based on the proposals in this paper.

Our proposed market capitalisation bands are identical to those implemented by the FSA for its UKLA fees and are unchanged from 2006/07, which will reduce the costs of collecting our levy. The proposed minimum levy and the rates in the other bands differ from those proposed by the FSA: the number of companies liable to pay our levy differs from those who pay the UKLA fees and our costs are also different.

Assuming the inclusion of overseas companies with securities admitted to trading on a UK regulated market as proposed in this paper, we would be able to raise the total amount we require from the business levy with an increase of 5% in the minimum levy and 10% in the rates we apply:

Band	Market capitalisation (£m)	Levy per £m of market capitalisation 2006/07 (£)	Proposed levy per £m of market capitalisation 2007/08 (£)	Increase %
1	Up to 100	Min levy £800	Min levy £840	5%
2	100-250	5.00	5.50	10%
3	250-1,000	3.80	4.20	10%
4	1,000-5,000	2.70	3.00	10%
5	5,000-25,000	0.045	0.05	10%
6	>25,000	0.009	0.01	10%

* overseas companies will receive a discount of 50%

The following example illustrates the way in which the 2007/08 levy would be calculated for a UK Main Market company with a value of £350m:

Market capitalisation band (£m)	Levy payable in 2006/07 (£)	Levy payable at 2007/2008 rates (£)
Up to 100	800	840
100-250	750	825
250-1,000	380	418
	Total 1,930	**Total 2,083**

Consultation question:

3. **Do you agree with our proposed levy rates for 2007/08?**

We will announce the final rates payable in June 2007.

Including other publicly traded companies in the scope of the levy from 2008/09

We consider that for 2008/09 and future years, the scope of our business levy should be extended to include a wider range of publicly traded companies, such as those on AIM and PLUS Markets, which are within the scope of most of our regulatory responsibilities but which do not currently contribute to our costs.

When the FRC was first established the London Stock Exchange's Main Market was the only forum for public trading in companies' shares. The position now is different - with AIM trading shares in significant numbers and values of companies, and PLUS Markets also having a primary market offering.

AIM and PLUS Markets companies and their auditors are subject to the accounting and auditing standards which we set, monitor and enforce. The only significant aspects of our work which do not apply to these companies are our work on the Combined Code on Corporate Governance and on the implementation of the requirements of the 8th European Company Law (Auditing) Directive relating to the registration and inspection of overseas auditors - which currently account for less than 5% of our costs.

The trend towards a decline in the number of companies on the Main Market coupled with an increase in the number of companies on other markets has continued for some years and is expected to continue in future. The amount of our costs which can be fairly attributed to companies traded on other markets is not de minimis, but the business community's share of those costs is being met by a declining number of listed companies.

There is, therefore, a degree of cross-subsidisation between the Main Market on the one hand and AIM and PLUS Markets on the other which we believe is no longer defensible.

AIM

AIM was created in 1995 by the London Stock Exchange plc. Although the regulatory regime for AIM is less prescriptive than the Main Market, which is regulated by the FSA, companies quoted on AIM are subject to the disciplines associated with being publicly traded and are subject to public scrutiny of their performance. There are currently over 1,600 UK companies quoted on AIM, with a total market capitalisation of around £96 billion. AIM has experienced particularly significant growth in the last three years.

PLUS Markets

PLUS Markets Group ("PMG") is an independent UK provider of primary and secondary equity market services. Its primary market specialises in smaller companies representing a wide range of sectors and all stages of development. There are currently around 190 UK companies quoted on the primary market with a combined market capitalisation of over £2.4 billion. The market is intended to create the benefits of being traded on a public market within a regulatory environment designed specifically for smaller companies.

FRC views

In 2005, we proposed that our business levy should be extended to include AIM and PLUS Markets (then Ofex) companies in order to achieve a fairer allocation of the costs of our work across the business community. This proposal did not attract support at that time.

In 2006, we did not repeat this proposal, but explained that we would keep under review the issue of whether a wider range of publicly traded companies work should contribute to our costs.

We believe that the arguments for including UK AIM and PLUS Markets companies within the scope of the business levy are even stronger now than they were two years ago, and we are repeating our proposal for the business levy in 2007/08.

We acknowledge that there are differences in the regulatory regimes which apply to UK AIM companies and UK PLUS Markets companies; but we believe that the two markets are substantially similar as regards our activities.

In 2005, we proposed that AIM and PLUS Markets companies should receive a discount of 25% on their levy compared with companies on the Main Market to reflect the fact that AIM and PLUS Markets companies have lower regulatory costs, and a lower profile, than Main Market companies. We have reviewed that proposal and are now proposing that they should receive a discount of 50% on their levy compared to companies on the Main Market. The market capitalisation bands mean that the vast majority of AIM and PLUS Markets companies would pay only the minimum levy.

The extension of the business levy to UK AIM and PLUS Markets is not intended to generate additional income for the FRC: we will continue to operate within our published budgetary limits. It would, however, ensure a fairer distribution of the costs of our work across the business community. If AIM and PLUS Markets companies were to be included within the levy then we would be able to set rates for companies listed on the Main Market which would be lower than would otherwise be the case.

Consultation questions

4. **Do you agree that it is right in principle that our business levy should be extended to companies traded on AIM and PLUS Markets? Are there differences between AIM and PLUS Markets which are relevant to the applicability of the FRC levy?**

5. **Is the proposed 50% discount for companies reasonable?**

If our proposal to extend the scope of the business levy to other publicly traded companies is accepted, we will give further consideration as to how this could be collected in a cost-effective way before we consult on our levy proposals for 2008/09.

Three – Levies on insurance companies and pension schemes

Funding our responsibilities for actuarial standards and regulation

Our objectives in relation to our actuarial responsibilities are:

- to set independent and high quality standards in relation to pensions, insurance and other matters where actuaries provide advice
- to promote the integrity, competence and transparency of the Actuarial Profession

to the benefit of all those who rely on actuarial advice, directly or indirectly.

We are working closely with the Pensions Regulator and the FSA to ensure that our standards provide, where appropriate, the necessary basis for actuaries advising pension funds and insurance companies to provide advice in a form which enables those entities to comply with the Pensions Regulator's guidance, DWP Regulations and FSA rules. In addition to our standard-setting role, we are overseeing the activities of the Actuarial Profession in regulating its members and implementing the recommendations of the Morris Review, and we are extending our independent disciplinary arrangements to cover public interest cases involving actuaries.

Following consultation in the context of the Morris Review of the Actuarial Profession – and further consultation by the FRC - it was agreed by HM Treasury that the costs the FRC incurs in relation to its responsibilities for actuarial standards and regulation should be met by the main beneficiaries of the new arrangements: life and general insurance companies, pension funds and the Actuarial Profession.

This is in line with the way that the Pensions Regulator and FSA are funded. The actuarial standards for which we are now responsible are relevant to users of actuarial advice, the administrators, trustees and managers of pension funds and the directors of insurance companies as well as to those providing such advice.

Our arrangements for funding our actuarial responsibilities are designed to ensure that pension funds, insurance companies and the Actuarial Profession contribute a reasonable share of the costs we incur, and that the arrangements for collecting the contributions are as straightforward and cost-effective as possible.

It is our intention to fund our actuarial responsibilities in 2007/08 on the basis which was developed following public consultation and applied in 2006/07:

- A contribution from the actuarial profession equivalent to 10% of the total costs incurred in relation to actuarial standards and regulation

- A contribution from the insurance sector through a levy on the “insurance levy group” equivalent to 45% of the total costs. The insurance levy group will comprise life and general insurance companies which are required to pay the relevant FSA regulatory fees (FSA fee blocks A3 and A4)
- A contribution from the pension sector through a levy on the “pension levy group” equivalent to 45% of the total costs. The pension levy group will comprise pension schemes subject to the Pensions Regulators’ General Levy, identified on the basis of information on scheme membership provided to the Pensions Regulator in its scheme returns and subject to a de minimis amount.

The Companies (Audit, Investigations and Community Enterprise) Act 2004, as amended by the Companies Act 2006, provides a power for the Secretary of State to make regulations enabling the FRC to recover its costs in relation to actuarial standards and regulation through a levy. It is intended that our actuarial responsibilities should continue to be funded through non-statutory arrangements on the basis of an understanding with the pension and insurance sectors and the Actuarial Profession in a way that takes into account the benefits our activities should provide for these groups in particular. However, should a non-statutory approach prove unsustainable, the statutory powers may be invoked.

Total funding requirement

The total costs we incur in relation to our responsibilities for actuarial standards and regulation in 2007/08 are expected to be as follows:

	£m
Actuarial operating costs	1.8
Actuarial disciplinary case costs fund	0.3
Recovery of set-up costs	0.1
Total	**2.2**

Proposed funding arrangements for 2007/08

The FRC will seek contributions to these costs on the basis set out above.

Contribution from actuarial profession

We will seek a contribution of £220,000 (10% of total costs) from the Actuarial Profession.

Insurance levy group

We will collect a levy of £990,000 (45% of total costs) from insurance companies in FSA fee-blocks A3 and A4. This will be allocated to individual insurance companies in the same proportion as the FSA regulatory fees and charged to insurance companies on the same invoice as the FSA fees. The levy will be collected on our behalf by the FSA at the same time that it collects its own fees.

Our levy on insurance companies will be an amount equivalent to 1.7% of the FSA's estimated regulatory fees for Fee-blocks A3 and A4 for 2007/08 (£59.8m), announced in February 2007.

Pension levy group

We will collect a levy of £990,000 (45% of total costs) from the pension levy group in 2007/08, on the basis of a levy of £2.10 per 100 members on pension schemes in the pension levy group, using the information on scheme membership provided to the Pensions Regulator in its scheme returns.

For 2007/08, there will be a de minimis contribution of £21. This will have the effect of including within the scope of the levy only those schemes with 1000 or more members - around 2000 schemes, representing approximately 85% of the total membership of pension schemes.

If there are any outstanding amounts from the 2006/07 levy we will seek to recover those amounts during 2007/08.

We expect to invoice the pension levy group earlier in 2007/08 than was the case in 2006/07.

Consultation question

6. **Do you agree with the proposed funding arrangements in relation to actuarial standards and regulation?**

Contact Details

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