

UKSA

UK SHAREHOLDERS' ASSOCIATION

The independent voice of the private shareholder

UKSA'S RESPONSE TO 'INVESTMENT COMPANIES SHARE REPURCHASES USING CAPITAL PROFITS' - A CONSULTATIVE DOCUMENT FROM THE DTI

12 MAY 1999

A. SUMMARY RESPONSE

1. UKSA supports the proposal that company law be relaxed to allow investment trust companies to use capital profits to repurchase or redeem their own shares.
2. We would not want liberalisation to extend beyond this proposal without further consultation.
3. Other existing restrictions on the repurchase of shares out of revenue profits should remain in place, but the general restrictions on buybacks that apply to other listed companies should be sufficient for investment trusts.
4. We do not feel qualified to comment on safeguards for the protection of creditors.

B. DETAILED RESPONSE

1. Should company law be relaxed so that investment companies be allowed to use capital profits (in addition to revenue profits which they may presently use) to repurchase (or redeem) their own shares?

Yes.

When investment trust companies repurchase their own shares in the market at a significant discount to net asset value, the repurchase directly increases the net asset value of the remaining shares, providing an immediate and significant benefit to the remaining shareholders. This is equally true whether the shares are repurchased out of capital profits or out of revenue profits.¹

¹ We should note here that buybacks are not always appropriate: the argument that they result in a permanent reduction in the net asset value discount is far from proven, and reducing the size of an investment trust through buybacks is sometimes damaging to the shareholders' interests. However, these are matters for boards of directors and shareholders to consider - not reasons for regulatory constraints.

www.uksa.org.uk

Information Line: 0171-244 9777

We agree that the existing constraint can make the process of arranging share repurchases more complex and expensive than is necessary, where those repurchases are in the interests of shareholders, and that any protection it provides to shareholders against abuse is more effectively provided by other means (as described in the Consultative Document, paras.51 to 52).

The consultation paper notes² the concern that the proposed reform would blur the distinction between investment trust companies and unit trusts or OEICS. We do not share this concern: there are, and will continue to be, fundamental differences between investment trust companies and other collective investment vehicles.

The question of whether investment trust companies, unit trusts and OEICS should all be subject to the same form of financial regulation is a completely separate issue: the proposed reform should be considered solely on the basis of whether it will be of benefit to investment trust shareholders - and we believe that it will.

2. If the answer to question 1 is yes, should the relaxation go further so that investment companies be allowed to use capital profits to make any distributions with the exception of dividends? Such distributions would include, for example, certain permitted forms of financial assistance.

Not without further consultation.

We would certainly want to know what was envisaged before we could express a view.

3. If investment companies are to be allowed to use capital profits to repurchase their own shares, should there be any restrictions such as a limit on the frequency that shares may be repurchased or on the value of the shares that may be repurchased as a proportion of share capital? If so, why?

Yes and no.

The existing restrictions on the repurchase of shares out of revenue profits, as described in paras. 51 and 52 of the consultative document, should of course remain in place.

We do have concerns about the scope for abuse with share buybacks, where these are made above the prevailing market price. However, this is equally true for all companies, and investment trusts should not require additional constraints beyond those that apply to other companies.

4. If investment companies are to be allowed to use capital profits to repurchase their own shares, would this give rise to any concerns about creditor protection?

As representatives of private shareholders, we do not feel qualified to comment on the issues relating to the protection of creditors.

² Paras.40 to 43