

Why is changing things so hard?

Reflections on the period since we started UKSA and some radical conclusions – and challenges

by *Martin White*

If we look back to 1992, prior to starting UKSA there was no organisation in the UK set up to represent the interests of private investors. Many other countries had got there some time before. One of the reasons for this may be that there were less developed, and less competitive, services for investors in those other countries so that they had a gap to be filled relative to the UK.

What got UKSA off the ground was disgust at developments in executive pay. The privatisation of public utilities was a case in point; some of us will remember the protests at the hike in pay of the chief executive of British Gas. A single letter in the Investors Chronicle got a number of responses, and then we were off.



From the beginning, probably the strongest focus was representing private investors in general. The motivation for joining was never really seeking individual investment advantage of any kind; it was to be part of something set up to make a difference. And it wasn't just the lot of private investors that we cared about. We recognised that good company behaviour was a plus for the whole of society, so we had this very much in our sights too. One of the initial papers that we produced was titled "the rights and responsibilities of shareholders". Of course, being part of a network of individuals interested in investment can be helpful to one's investment performance; there are lots of contacts, situations and insights I would personally have missed out on but for UKSA.

Over the years, our representational, or policy, work has been moderately effective. That is to say that when questions of public policy came onto the agenda, usually in the form of Government consultations, very small UKSA teams worked hard to put in good quality responses and these were certainly listened to. Officials are generally quite aware that most of the responses they get, on pretty well anything, are from or on behalf of commercial organisations with an axe to grind. So whilst we were often a single voice representing individual investors, our efforts were appreciated and taken seriously. And that work continues today; from 1992 to 2018, we've been at it for 26 years now!

The limitations of polite and constructive lobbying

So, 26 years on and what have we achieved? Well, we'll never know what policy decisions would have been made by Government had we not been putting in our pennyworth, but let's face it, the world for the individual saver in general is probably a bit worse, and as for the behaviour of the corporate world overall, that's so much worse as to be a fairly constant scandal. Persimmon, Carillion, Tesco, Sports Direct – the list is never-ending.

Why the bad picture on corporate behaviour? One of the very best accounts of the underlying problems came out in the early 2000s. Donald Butcher, UKSA Chairman at the time, and I went to a launch meeting on this – a substantial paper by Robert Monks and Allen Sykes entitled "Capitalism without owners will fail". You can find it at <http://archives.ragm.com/libraryFiles/100.pdf>; I suggest taking and saving a copy just in case it disappears from the public domain.

So: "Ownerless corporations?" Really? Yes – this term was given some publicity by Paul Myners, a City grandee who did a stint in the last labour government – and a great speaker who has spoken at a number of USKA events. The point is this: for a variety of reasons (including some that cause us great concern) there are now fewer and fewer of what we might call "true shareholders" on companies' share registers, and instead there will be the name of the nominee company. If you have money in ISAs or SIPPs, then even if you do take the (cost-effective and intelligent in my opinion) self-select route, picking individual companies and investment trusts yourself, then you will still be invisible to the companies you invest in. As members will know, we have been campaigning to change this state of invisibility, and Eric Chalker has worked hard on this, but we have to face the fact that the current situation suits many financial sector actors quite nicely. For example, without our knowing, the nominees sometimes enter into "sale and repurchase agreements" commonly known as "stock lending" for a fee

that we don't see – a process that oils the wheels of the short-term gambling business that is short selling and derivatives.

In practice, companies are controlled, or at least influenced, by the main preoccupation of those who do the big buying and selling, namely the investment management sector. And, for various reasons too complex to go into here, this sector does not act as if they are owners; instead we have a situation where “short-term share price performance is everything”.

We all know the extent to which the current focus on short-term results is deeply embedded in our national life. Encouraged by the mainstream consensus on “necessary incentives”, executives are led to expect that “getting rich quick” is an appropriate objective and a just reward for presiding over a period when the company's share price rises. That leads to the suggestion that you won't get the best company leaders unless you do offer them really vast rewards. Well, I simply don't believe that. It's a message that it greatly suits the establishment to keep repeating, as it continually increases the “going rate” for company leaders, but the way I look at it is that it attracts the wrong kinds of leaders, and may even corrupt the right kinds of leaders. It's not as if the problem is not widely recognised; in the UK we had the Kay Review in around 2011, and just before that the EU did a study into “short-termism and excessive risk-taking”. Out of these came some good ideas, which didn't really get anywhere. And the reason they don't get anywhere is quite simply that they don't suit those in power, the “establishment”. And the establishment runs much deeper than you might think. Even various think tanks and charities get donations from the corporate sector. I have attended plenty of meetings to discuss corporate governance issues, and I have found absolutely no appetite to address the matter of executive pay. I often manage to put a very direct question to the panel on this, and almost without exception there is an uncomfortable shuffling and they all want another member of the panel to answer. I normally get no answer at all.

The true power is with the financial sector (by which I mean mainly the investment advice, investment management, and investment intermediation industries, including some aspects of banking), which is very profitable on the back of society's generally limited financial awareness and capability, and whose own pay levels often mean that they cannot with credibility challenge pay in the corporate non-financial sector. They also have huge lobbying budgets; what we get in consequence is regulatory capture. It's not just the Tories; even Labour MPs sometimes end up with jobs in the financial sector, and there are well known cases of senior regulators getting senior jobs in the financial sector. I'm not alleging inappropriate behaviour by individuals, but regulatory capture is an insidious thing and difficult situations can develop without any evil intent.

What is to be done? I am completely convinced that the “normal” ballot box and the normal processes of democracy are not going to change the system. That's not to belittle our democratic process in the UK; I believe that it is quite easy for individuals to feed ideas into government and media and be listened to. But the fundamental block to getting anywhere is that “limited financial awareness” problem. And I am convinced that “more financial education”, which is often put forward as the solution to everything, won't work either. People need much more support than just financial education – and one of the main themes in my set of radical ideas is providing just this. We are not going to make much difference until we start changing the behaviour of savers, and how to do this is 90% of the challenge that I am now going to set out.

A new UKSA project: “Savers Take Control” (STC)

(The website now has a dedicated page at http://www.uksa.org.uk/Savers_Take_Control)

I first wheeled this idea out at an event last September organised by the Transparency Task Force to mark 10 years on from the run on Northern Rock. And you can see my presentation on our website by scrolling down the news pages. You can even find it easily by just googling “savers take control”; I'm rather pleased about that! I had just 20 minutes to give the presentation, so I put a lot of detail in the slides so they could provide sufficient information and context to someone reading them later from scratch.

What's so radical about STC? Many things, but I would highlight the following:

- Independent of all arms of the establishment;
- Essentially a charitable motivation, the aim being to help the whole of society;

- Purely dependent on volunteers, including volunteers with very deep knowledge of the operation of investment, of the financial sector and the world of corporate governance – many of whom will be retired from the financial sector but with energy and passion to contribute.

Whilst we will build up a wide network of friends and advisers, some of whom will be reluctant to actually join UKSA, the core UKSA STC team is to be completely independent from financial and corporate sectors. For me this is completely vital and non-negotiable. We do not want there to be any hesitation in proposing ideas that will upset the status quo, or will challenge the accepted wisdom in areas such as executive remuneration and incentives, or even financial education. We will be very happy to work with and talk to anyone, including those that disagree with us, but I'm not going to compromise on that independence. But people who are now retired from the financial sector may well fit the "no conflict" test; indeed I often come across such people who feel that lots of things need to change but who have been unable to speak up whilst still working in the sector, and we already have some new recruits from this source.

I want to build an element of public awareness of what we are doing, and why, from the outset. As well as any existing members who want to engage with the project, I am expecting new people to join UKSA who hear about what we are doing in the media, and share our passions. We don't need many people to start with, but we do need a mix of skills and experience to join the core team. Including presentation and media skills; we don't just need the technical thought-leadership types. But enjoying collaborative working, including when we don't all quite agree with each other and are learning as we go, is really important. Ultimately I would expect that UKSA as a whole will benefit greatly from the new talent that is attracted to us by STC.

In order to work towards the kinds of changes that, as I have explained above, the existing establishment will simply not support, I have concluded that we need to work concurrently on developing a number of ideas and resources. We think in terms of two broad areas of need for change. They are: A) improving the lot of the ordinary saver and investor; and B) influencing the behaviour and culture of the corporate sector. It is essential to work on both, and to do so publicly, and the initial requirement is for what we might call "collaboratively minded thinkers" who share our diagnosis and passion for change.

As already mentioned, having no conflicts in relation to the areas where we want to influence is a pre-requisite for joining the core STC project team. So if you work in the investment management sector, or the financial advice sector, great, you can join UKSA but not the STC team. But it's broader than that; existing company directors and advisers, and senior executives, are also likely to be conflicted. One of the key themes of STC is that the relationship between company managements and shareholders (including here the true underlying owners, the individual pension fund members and savers in pooled vehicles) is one of stewardship. And, most importantly, stewardship involves the steward not helping themselves to the assets that they are there to steward. Anything that causes a focus on share price is a huge problem. And that includes share options.

So what's the proposal? No doubt the team will develop better and more snappy terms, but the two concurrent and extremely challenging work streams are:

- 1) Investment solutions and financial capability for individuals; and
- 2) Principles of stewardship and corporate behaviour, including relationships with both shareholders and employees.

Some PR/media activity will be needed soon, when we have sufficient credible material on our website to approach the media with. And the key message we want to get out in the first instance is that we are looking for people to join the core STC project team, so this will need a good story for the media to understand and react to. We envisage a number of events taking place from time to time, some closed to members only, some much more outward facing. We will work steadily, taking care not to tackle too much too quickly.

This is an exciting journey into the unknown. I think it's going to be fun. We are now at the first step in what, if it does any good and makes some useful changes, will take some years, and the organisation we develop to achieve it will itself develop, and one can't predict at the outset just what that development will look like. Ideas welcome, providing you are in sympathy with the main principles! E-mail stc@uksa.org.uk. I have written a couple of short pieces on each of these two work streams in this issue of TPI. I hope you enjoy them.

Aviva preference shares campaign

by Peter Parry

On 8 March the normally sleepy world of irredeemable preference shares received a shock of seismic proportions. The insurance giant, Aviva, announced that it was planning to cancel 450 million of its irredeemable preference shares. Although the shares were listed as being irredeemable, a legal loophole gave Aviva the right to cancel the shares when it chose and refund investors at par. The proposed action by Aviva hit the market for the whole of this class of shares hard, with some issues falling by 45% on the day of Aviva's announcement.

UKSA and ShareSoc immediately started a campaign to oppose Aviva's plans. Cliff Weight of ShareSoc led the campaign drafting letters to Aviva, the FCA and the FRC which were jointly signed by UKSA and ShareSoc. Cliff also worked closely with Mark Taber, an expert in fixed-income securities who has successfully fought many past battles on behalf of private investors in bonds. Even a number of institutional investors were up in arms and made their views clear to Aviva.

We emailed UKSA and ShareSoc members and urged them to write to their MPs about the issue, the dangerous precedent it was likely to set and the potential damage it would cause to the reputation of the London Stock Exchange. Suffice it to say that, just as members were getting ready to ruin their MPs' Easter break on account of Aviva, the Company announced on Friday 23 April that it was backing down and would not go ahead with its plans.

This action has been another excellent example of how joint working between UKSA and ShareSoc has been enormously effective. On this occasion we have collaborated to add pressure of our own as well as contributing to a wider campaign that was gathering momentum. Not only have we worked together we have also managed to ensure that our campaigning approach and strategy were coordinated with other third parties to achieve maximum effect.

Savers Take Control

Two project themes presented by Martin White

(please see main article on page 11)

Theme 1: Investment solutions and financial capability for individuals

This project work stream has a very ambitious long-term objective, and I think a unique intention for how to achieve it. These two features can be expressed very simply as follows:

- The aim is ultimately to help everyone, not just the most sophisticated and wealthy (and obviously not just UKSA members!)
- The leadership of the project, and all the thinking, is to be done by unpaid volunteers who are independent of the financial sector, and who therefore have no conflict with there being ultimately a massive reduction in the share of the national wealth which is extracted by the financial sector.

It is important to be clear about the "help everyone" objective from the outset. And that this is clear to journalists who may take an interest.

It is vital to recognise that achieving aims this ambitious means there is a long road ahead. You have to start with what you can actually achieve, one step at a time.

Funnily enough, John Kay wrote a book that's entirely relevant to this kind of difficult challenge, called *Obliquity*. This was about the fact that you can't achieve complex goals directly, you have to go in the general direction towards those goals, and continually re-evaluate where you are, re-plan, etc.

I see stage one of this project mostly involving existing investors, and also people who already have the skills and attitudes that mean they will learn rapidly and be able to work out many things for themselves. What I hope we can develop is some "investment solutions" that make sense and, most importantly are inexpensive. The critical aspect of "inexpensive" is avoiding annual percentage charges, pretty well altogether. And the main route for this is self-select services, where there is no stockbroker or intermediary taking an annual percentage charge. That argues strongly against most managed funds. And it also disqualifies "platforms" who charge an annual percentage of everything you hold through them, but they may be OK if there is an annual platform charge cap, like £200 per annum. However, taken together, financial advisers and other intermediaries and fund managers are able today to take thousands of pounds from some individuals every year.

One of the reasons that the financial sector gets away with such murder in terms of its charges is what is euphemistically called "information asymmetry".

As well as simple and inexpensive "investment solutions", people also need an understanding of the investment fundamentals, including how to deal emotionally with market fluctuations and with uncertainty – the unknowability of the future.

A successful stage one of this project would be the establishment of the UKSA STC project as a force for change, where people could begin to come to us for information, help and fellowship in learning about how to think about and manage their long term finances. All within the regulatory constraints of not actually giving "regulated investment advice". I'm not thinking much beyond Stage one at this point; there are lots of potential options for bodies we could work with – we could even develop course material that could be used in evening classes. But a growing body of people who are clued up about, and enabled to insist on, inexpensive solutions would have an impact on the competitiveness of the financial sector, and the whole of society should benefit.

The term "Savers Take Control" itself derives from savers taking control of their own finances, and ultimately taking control of the investment-related part of the financial sector as intelligent customers, rather than the current situation where the financiers and their marketing spin are effectively in control of everything!

Theme 2: Principles of stewardship and corporate behaviour, including relationships with both shareholders and employees

This project work stream is about developing a set of principles that we can campaign for companies to adopt, and we can also work to persuade the managers of passive funds to vote for in respect of all of their holdings. It is important that they are extremely well thought out and subjected to challenge, and this is exciting work for those of us who are interested in it. Whilst we can start out initially talking amongst ourselves, it will be necessary to develop a series of discussion papers, and to hold meetings and do things that attract public attention and interest.

There are all sorts of organisations that engage in "worthy" corporate governance discussions. So why should we make any impact? The answer is simple: our independence from the financial and corporate sector and our absence of attachment to the status quo, especially the status quo regarding executive pay. Because the principles we come up with will have the result of **reducing** executive pay in many instances. We don't start completely from scratch; there is quite a bit of OK academic research and commentary on leadership and motivation, and we can make use of this and engage with the authors in some instances. To whet your appetite, one interesting story, which can be found on the Reputability website, is "*Roads to ruin*" (https://www.reputability.co.uk/files/press/Roads_to_Ruin_The_Analysis.pdf), where a study was made of a range of different corporate disasters, and in every case the problem was found to originate at board level.

Here are some of the questions we already have on the agenda (I have lots of thoughts under each question but will hold back on them for now):

- 1) Apart from having the appropriate technical skills for the business, what are the personal, human qualities we want in company leaders, and what are the most important principles to challenge them on in terms of the corporate culture and how it impacts on the employees?
- 2) What are the broad business objectives we want to charge the Chairs of our companies with, in their role of “Chief Steward” – which is how I believe they should be viewed and expected to think.
- 3) Do you attract the right leaders by giving them a chance of getting very rich quite quickly and setting out certain objectives which, when achieved, trigger massive wealth transfer to them from shareholders? And would the right leaders make and pass proposals like the incentive scheme at Persimmon?
- 4) How do you attract, and perhaps equally important, identify and develop, good leaders from within companies?
- 5) What should intelligent and responsible interaction and dialogue between company managers and shareholders look like?
- 6) What would need to change for shareholders themselves to think in terms of companies' long term wealth creation capabilities, as opposed to short-term measures like share prices?

It is interesting to note that section 172 of the current Companies' Act, reads as follows:

“172 Duty to promote the success of the company

- (1) *A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—*
 - a) *the likely consequences of any decision in the long term,*
 - b) *the interests of the company's employees,*
 - c) *the need to foster the company's business relationships with suppliers, customers and others,*
 - d) *the impact of the company's operations on the community and the environment,*
 - e) *the desirability of the company maintaining a reputation for high standards of business conduct,*
and
 - f) *the need to act fairly as between members of the company.* [Ed: the Aviva preference story comes to mind here!]
- (2) *Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.*
- (3) *The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.”*

The view of many people is that there is actually nothing wrong with Section 172 – the law is OK, the problem is that the principles are not really thought about when deciding what gets a “well done” within companies. A bonus-driven culture simply is inconsistent with S172.

As ever, all comments and suggestions are welcome.