

# **The Private Investor** *Issue 176 · May 2015*

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## **Chairman's Comment**

Thank you to all those who came to the AGM for your helpful comments. We'll do our best to take account of them.

Following the BHP Billiton meeting on the South32 merger proposal, Nick Steiner took the initiative of writing to the company questioning a number of grey areas in the potential trading of South32 shares. These questions and the company's response are on the website in a new tab - 'Members' Advice' - under the 'Members Area' tab. What do you think?

Phil Clarke, whose initiative set up the regular meetings with Standard Chartered, tells me that UKSA gets a mention in their annual report. Have a look through your annual reports and let me know of any other mentions of UKSA. **It's a measure of our increasing influence.**

Those of you on email will already know that we gave some help to Mr & Mrs Hemment (we welcome them as members) whose story of being charged £25,000 for a lost certificate was reported in the Sunday Times (and thank you for sending your experiences in support of their case). A piece of fallout from this was that the Head of Communications at Hargreaves Lansdown, Danny Cox, when asked for comment by the journalist, was quoted as saying: "Share-holders who have certificates sometimes mistakenly believe they do not have the same rights and benefits under a nominee service, thinking they miss out on shareholder perks and the right to vote and attend annual meetings. This is not true." **As a Certified Financial Planner Mr Cox should have known better. In** the tightly controlled environment for financial advice this episode raises regulatory issues which we are taking up.

Welcome to Malcolm Hurlston, founder and Chairman of the Esop Centre, who has joined UKSA. His article appears on Page 8.

We are beginning to gear up for the London Investor Show on October 23. Put it in your diaries, volunteer if you can, and drop by the stand anyway.

***Good luck  
John Hunter***

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## Mohammed Amin

We have recently made the acquaintance of like-minded Mr Amin who amongst other things runs a lively investment website. Here we reproduce one of his recent articles:

*I recently attended a [talk by Mr Terry Smith](#), Chief Executive of Fundsmith LLP, which was given to the Conservative Muslim Forum.*

*'One of the points he made is that management charges can have a big impact upon your investment outcome. To illustrate this he referred to Berkshire Hathaway, the investment company that since 1965 has been managed by Warren Buffett. He said that if you had invested \$1,000 in Berkshire Hathaway when Warren Buffett took over, by now it would be worth over \$4 million. That did not surprise me, as the statistic is well known. Such sustained performance over such a long period demonstrates Warren Buffett to be one of the greatest investors of all time.*

*'Mr Smith went on to explain what would have happened if Warren Buffett had made the same charge for his services as many hedge fund managers, namely 2/20. As probably the greatest investment manager in the world, it would not be unreasonable for him to charge such a fee. 2/20 means charging an annual management fee of 2% of assets, and a performance fee equal to 20% of any positive growth. Mr Smith stated that if these charges had been made, instead of over \$4 million you would only have about \$400,000.*

*'The other 90% of the growth would have ended up with Warren Buffett if he had chosen to reinvest his management fee income back into Berkshire Hathaway. (Even if Warren Buffett spent the management fees, you would still only have \$400,000!)*

Mr Amin's entertaining comments can be readily accessed at this address:  
<http://www.mohammedamin.com/Finance.html>

### UKSA

Talking of websites there has been an upgrading of our own website, [www.uksa.org.uk/](http://www.uksa.org.uk/). Members are strongly advised to enter the address into their favourites list and take a note to visit it regularly. You won't be disappointed!

**Put this in your diary too! On 9th June members have the chance to join in an analyst-style presentation by Mark Bottomley, Finance Director of Cranswick, whose succulent products garnish many a table both here and abroad. This is the latest opportunity for UKSA members to recoup the annual fee by a factor of ten, if they experience gleaned from past meetings is anything to go by. Contact Julian Mole at [Julian.mole@btinternet.com](mailto:Julian.mole@btinternet.com)**

## A new policy structure for UKSA

by Eric Chalker, Policy Director

At our recent AGM, I outlined my thoughts on a new policy structure for UKSA. This has since been put to our board of directors and approved. It replaces the structure reported on the front page of this magazine in March 2012.

The purpose of the new structure is to give us greater flexibility in tackling an increasing number of policy areas and making good use of an increasing number of volunteers from among our members to do this. At the same time, we must also ensure that the things we say are broadly representative of private investor opinion generally and our members in particular, are consistent with each other and made subject to a sensible process of authorisation. Members of our policy team will be those designated by me: we currently have ten, including myself; this is an impressive number, but there is still room for more. Some will have continuing responsibility for certain matters, while others will undertake specific tasks of a limited nature.

**My objective is to tap members' expertise, their experience and above all their enthusiasm, to use our reputation and public standing as the principal body representing the interests of private investors, to press for changes in the law, in regulation, in institutional attitude and in director behaviour.** Many of our objectives have been written about in these pages and can be found on our website, but other matters of concern have yet to receive our attention.

**Where we see private investors' interests disregarded, or worse still abused, that is where our attention should be focused.**

This is not a selfish matter. The act of investing in equities is of course done for personal reasons, for income and for growing wealth, but it is responsible citizenship too. Private savings, one way and another, are ultimately the principal source of the money invested for the generation of wealth by those engines of profit and growth, the businesses upon which society as a whole depends for its future well-being. Some of us are lucky enough to have the means and ability to invest our money directly into company shares, which I believe gives us not just the opportunity to watch over how that money is used, but a particular responsibility to do so. We have a perspective which governments, regulators and even businesses should value, because it is special.

We have been making progress on a number of fronts, as has been reported, but it needs to be sustained. Recently, a new front has opened up, which is now receiving attention. This is the launch, by European Commission

President, Jean Claude Juncker, of his plan for a Capital Markets Union, reported elsewhere in this issue and on our website. Alongside this is a review **of the EU's Prospectus Directive which is also mentioned in another article.** EU matters are becoming more important to us and whereas we have long depended on the sterling efforts of Harry Braund and Martin Morton to represent our interests 'over there', **these now need to be supplemented on the policy front,** so if there is a member with particular interest in watching developments in Brussels as they affect private investors, please let me know.



Eric Chalker

Here at home there are developments too. One of these concerns audit statements, which, as members will have seen, have become more complex **and informative. In a year's time, this will be even more so, because of the new corporate governance code requirement for directors to report on companies' 'viability'.** This will be no small matter, as was explained at an early morning seminar this month run by the 'big four' accounting firm, EY, attended by Peter Parry and me. It comes into force for all accounting periods commencing on or after October 1 2014 and it is definitely something to be watched by investors, as will be explained in a future article.

**Another of the 'big four', PWC, is also anxious to talk with us about its new audit statements.** No date has been set for this yet, but Roger Collinge and I are keen to find an UKSA member with an interest in the audit process, because this invitation is surely an opportunity not to be missed. If this applies to you, please contact me!

It seems evident to me that whereas audit statements had become almost completely predictable and therefore of less value than should be the case, the efforts of the Financial Reporting Council to elevate the demands placed on auditors are beginning to have an effect and this is going to increase. Although appearance is frequently to the contrary, auditors are supposed to be appointed by and answerable to the shareholders, not the directors, so it is good and healthy that changes are afoot. I look forward to seeing auditors challenged at company AGMs – and that needs some thought too.

UKSA is becoming quite a powerful force for good, in the interests of all private investors. If you would like to be involved in this side of our activities, do let me know.

**Eric Chalker**

## **The Alliance Trust Debacle**

**By Roy Colbran**

37 members replied to our email enquiry telling us that they held Alliance Trust and there are probably more who did not reply. This seems to justify a few lines in Private Investor despite all that has been said in the press. UKSA Directors took the view, correctly in my opinion, that it would not be right to make a recommendation to members on voting but instead to provide a forum on the website where members could record their views. Eight members did so. Alliance Trust approached us to see if we could help them pass on their views to our members and we simply included a link to their response on our website.

Seeing the amount of effort Alliance put in to urging their shareholders to vote against the Elliott proposals, it is not surprising that, according to reports, shareholders at the AGM were very angry at the outcome. I thought the way that the Trust responded to the approaches did not help them. Casting such strong aspersions on the independence of the proposed directors seemed a very negative response, especially bearing in mind that by Company Law they would be bound to act in the interests of the Company and not Elliott. It is frustrating that after going to all the trouble to vote, we shall never know what was actually happening.

The percentages voting in the regular resolutions that were put to the meeting were all within the range 46% to 49% of the total shareholding. It is possible that slightly higher percentages voted for the Requisitioned Resolutions but even so with Elliott starting at 9.95% they needed only to get another 15% to support them to carry the day. Several institutions had said publicly that they backed Elliott so one can guess that they did not need many private **shareholders' votes to carry the day.**

We now have two additional directors out of the three originally proposed by Elliott. Only one of the two took the trouble to turn up at the AGM. He, according to the press reports, admitted to no knowledge of Alliance other than



***Katherine Garrett-Cox***  
***Alliance Trust Chief***  
***Executive***

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what he had read in the press but did say he would be independent. This did not stop the Chairman from saying in her announcement that the significant experience of the new directors would be a considerable asset (some contrast to what she was saying before!) The third additional director is to be appointed in consultation with major shareholders – one wonders what happens to the views of private shareholders who, we are told, make up 70% of the total holdings.

Even with the new directors all acting independently, Elliott will still be in the background having promised to hold off only for another year. Some cost-cutting would certainly not come amiss but Elliott will be looking for improved performance. This leads to the worry that Alliance will go for short-term gains by methods inappropriate to a long-term fund. There is also the likelihood that they will be looking for what is euphemistically called a discount control mechanism. In other words buying back shares to improve the price.

I believe that buying back is undesirable and generally only of very limited effectiveness. Witan who have bought back to the extent of reducing the number of shares in issue by about half since the days of their full glory failed to have much impact on the discount until the market really began to believe in the success of their multi-manager approach.

In four years (i.e. after they started seriously buying back) Alliance Trust have reduced the number of shares in issue by one-sixth yet still leaving the discount at a level which the institutions find unacceptable. Hence there must be serious concern that because of this institutional pressure they will feel obliged to go proceed even more strongly in the buy-back process. This is **totally in contrast to their slogan "Investing for Generations"** and will sadly reduce even further the limited pool of investment trusts which are so much better as an investment for private individuals than open-ended funds. Being able to buy into a pool of assets at a material discount has always been a big attraction of investment trusts. As I write Alliance Trust on 13% does not look so far out of line.

Once again, Alliance Trust will be holding an Investor Forum for shareholders in London in the autumn – on September 29th. I shall be writing to them beforehand to ask them to make sure that (in contrast to previous occasions) there is ample time for reporting and questions on the way they are running the Company.

**Roy Colbran**

## The Strength of Employee Shareholding

**Malcolm Hurlston CBE**  
**Chairman Esop Centre**

There are now around a million shareholders in the UK who received their piece of the action thanks to employee share schemes (known as plans in the US, where “scheme” has a more negative connotation).

The Esop Centre has been in the forefront of campaigning for employee shareholding since it brought the Employee Share Ownership Plan to Britain in the 1980s. Most recently its advocacy was telling in ensuring that Royal Mail employees - over 150,000 of them - received real shares when the company was part privatised, as opposed to an indirect interest through a trust. Thanks to them employee shareholders came to top the million mark.

**The original idea from California was to spread the “wages of capital”.** A small business owner had wanted to sell on to his long term employees and was distressed that he had not been paying them enough for it to be affordable. This is where the trust mechanism came in thanks to local lawyer Louis Kelso who saw that a trust on behalf of employees would be able to borrow enough to buy the company and that the wages of capital would enable the loan to be repaid. Such transactions still happen but, in the UK as in the US, they account for a minor proportion of employee ownership. That results in Britain mainly from the share schemes introduced by companies large and small which make use of one or more of the four government approved approaches. Two – Sharesave and the Company Share Option Plan have been running now for 20 years or more; the most successful, introduced by Gordon Brown as Chancellor, the Share Investment Plan and the Enterprise Management Incentive. A controversial fifth approach was introduced by Chancellor Osborne and risks the chop under a LabLib administration.

BT is one of the great examples of success. At privatisation all employees could receive free shares and since then there have been frequent offers. Last **year’s Sharesave maturity after five years led to a £1 bn pay out to employees.** A high proportion of employees remain shareholders although some, not unnaturally, like to benefit from the occasional capital sum. On a smaller scale a Centre member told us last month that a career high spot was when the employees of a company he had advised received £50000 each: the wages of capital indeed.



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In recent times the John Lewis model has been widely touted. John Lewis is a retailing success but it is not a model: there is an opaque trust structure built on a gift from the founder. Few founders now give their businesses away. The LibDems in the Coalition government were keen on a trust based model for Royal Mail which would have denied employees true shareholding. Luckily Michael Fallon intervened in time and this approach was supported by a forward looking union in CWU (the deputy general secretary who arranged the deal won a recent ballot to become general secretary). However in Royal Mail, as elsewhere, the focus has been on the economic benefit of the shareholding not on the voting rights. The Centre believes – as does CWU – that employee shareholders should exercise full rights including voting. This is where the opportunity lies for close working between the Centre and UKSA.

Thanks to privatisation there has been some antagonism between trades unions and esops. The unions have been more concerned with defence than with finding new ways of helping their members. This is now changing and unions too can become a force. The Centre has been encouraging them from the start and at last there is traction.

The battle lines on privatisation are no longer clear. The failure of the privatised East coast rail service made most passengers prefer the best managed service, private or public.

Corporate democracy will work best if all individual shareholders exercise their full rights. We shall be talking to the three major administrators of share schemes in the UK to see how it can be made easier for all parties. I welcome UKSA members into indirect membership of the Centre; hope you will enjoy our bulletins and take part in our events, abroad and at home.

### Note on Centre

The *Esop Centre* was founded by Malcolm Hurlston with Clifford Chance and Unity Trust in 1985. It is now a members' organisation with around 100 members. Some are companies with plans; the rest are the leading experts among law firms, accountants, trustees, accountants and administrators in the UK and abroad.

The Centre holds annual events in Europe, the UK and the Channel Is; produces two monthly newsletters; lobbies and campaigns; publishes the quarterly Esop index which tracks quoted companies with over three percent employee shareholding; represents the sector on government committees and is a member of the Business Advisory Group to the OECD.

## Report on the Better Finance Conference, Brussels Tuesday 6th May 2015.

*by Harry Braund, FCA*

The conference was designed to put the spotlight on the proposed Capital Markets Union, the ambitious plan to develop a pan-European financial union & to persuade citizens & households across the EU to put their savings to work to help promote growth at a time when the EU is lagging behind the US & the big Asian economies.

The Commission plans to inject some vigour into the sluggish EU economy following the financial crisis of 2008. Seven years on the Northern European countries are in better shape compared to those in the south.

The keynote speaker was Jonathan Hill, the EU commissioner for Financial Stability, Financial Services & Capital Markets Union who was recently appointed as UK commissioner by David Cameron. The Commissioner's **message to shareholders, investors & the wider audience of EU 'citizen householders'** was to promote greater personal savings & investment in the interests of economic growth. This to be done in harness with the existing institutions - banks & investment funds (intermediaries) - but preferably in a more direct way, i.e. through new Euro Insurance schemes, as yet defined.

**One big issue is how to persuade investors to back SME's (small & medium sized Companies)** many of whom are at present starved of capital for the investment they need to grow. This is a more risky sector of the investment market compared with major corporations who can call upon an abundance of finance available through existing channels. It was clear however that SME's are a disproportionately important sector in ensuring growth.

New sources of capital have to be tapped - either directly or via existing channels. The perception is that far too many intermediaries are limiting access to capital. Banks and investment funds are calling the shots, many of which give a poor return on capital as UKSA members are well aware. Opening up the capital markets across Europe is a daunting task requiring new & more easily accessible investment instruments free of administrative 'drag' & **excessive costs. NOTE: let us not forget the 'negative return' on Pension funds** highlighted in the recent Better Finance research document. The aim is to attract new investors to put their savings to work in the market place without **too many 'intermediaries'** making the process more difficult, complex & expensive.

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The first group discussion entitled 'THE POLITICAL VIEW' brought together five MEP's members of the Parliamentary Economic & Monetary Affairs Committee (ECON) representing views across the political spectrum from left to right. Europe is still seen as a 'fragmented' market with great power in the hands of financial advisors & intermediaries who can & do influence outcomes. Too much so: they have to be reminded that they are dealing with OPM - other peoples money! The need is for 'a level playing field' plus transparency & ease of access to financial products which is important. The question of whether regulation has gone too far or not far enough was also debated.

The second group discussion representing THE MARKET VIEW included Jacques de Larosiere, former MD of the International Monetary Fund who stressed the need for more equity & less debt in Europe. Olivier Guersent representing the EU Directorate-General for Financial Stability, Financial Services & Capital Markets Union pointed out that the biggest problem for the EU was the lack of growth & the 'pile of cash' sitting in the market which was not doing the job for growth. Rainer Riess, DG of the Federation of European Securities Exchanges pointed out that Europe is now behind the USA & China as the 3rd largest market. A need to revive the process of bringing together capital & companies with an emphasis on SME's. Also a pensions regime where individual investors make their own decisions by direct investment (i.e. in the UK where it is possible to have a self-select SIPP which avoids a huge amount of charges). Moderator, Manuela Zweimueller, head of regulation at the European Insurance & Pensions Authority (EIOPA) looked forward to the day when a pan-European pension can be bought on the internet - by 2020! Retirement savings are the largest pot of money for individual investors.

### QUOTE FROM BETTER FINANCE STATEMENT:

***Over the years the European economy degenerated into a financial type of capitalism where the link between owners and issuers of securities (the real economy) has been severed, and where decision-making power finds itself increasingly in the hands of financial intermediaries as "agency" owners. Better Finance believes that it is time to "return capital markets to their natural participants" if the CMU is to stand any real chance of reinforcing the real economy.***

***Harry Braund***

## Making the most of AGMs

by Eric Chalker

Recently, I had the dubious pleasure of attending the Balfour Beatty AGM. This is a company which last year had six profit warnings, has stopped its dividend and changed some of its board – a board mainly comprising non-executives at a staggering cost of £750,000. I went because some things needed to be said and I was not alone. About a quarter of the 54 shareholders present asked questions and four of these were UKSA members. All were pertinent.

We should not under-estimate the effect that determined questioning can have, nor shy away from the opportunity to comment. Although there are good exceptions, company chairmen have a tendency to see AGMs as a gracious concession to those in front of them, not to be over-indulged in. Balfour Beatty has a new chairman, appointed after the annual report was **signed, so it was easy for him to suggest that the past was “another country”** and of little relevance now, but he had the grace to smile when one member said he was glad his predecessor had gone. He may not have smiled to see as many as 32% of votes cast against the remuneration report and equivalent to another 4% withheld.

This was one of those AGMs where those who had bothered to attend were denied the chance of showing their opinions by raising their hands. Everything went to a poll. I protested, as we all should do on such occasions. The chairman had the cheek to say this was done out of consideration for **us** – to save us the bother of going through the voting process. What rot. This **practice is adopted by those who don't want to see hands raised against them.** They claim it is more democratic and no-one would deny that ultimately the number of shares should decide issues rather than hands, but the ability to **show one's opinion is also a democratic right and this can't be done when** swamped by institutional shareholdings.

As policy director, I am beginning to see corporate governance as falling under two separate headings, one being reporting requirements and the other being how the directors – chairmen in particular – behave towards the ordinary **members, namely us. I've commented above on one aspect of behaviour, but** another aspect is what we are asked to approve every year in the AGM resolutions. This is a subject that needs some examining and I intend to do this in a series of articles over coming months. As I do so, I invite other members to comment on my thoughts in the letters pages of this magazine.

Let's begin with a simple one. The EU decided that all general meetings should be preceded by 21 days' notice, but (presumably under pressure) it allowed companies to escape this requirement, on a one-year-only basis and except for AGMs, if shareholders vote to reduce the requirement to 14 days. So important is this, however, that such resolutions have to be 'special' resolutions requiring majorities of 75% or more.

Routinely, we are asked to approve this reduction, but in my opinion we should routinely vote against. It cannot be in our interest to be told of a proposal, which has to

be major because it requires our consent, with two weeks' notice rather than three. This may be fine for institutional investors with staff to look after things, but not for ordinary investors who have to look after their own affairs. It is but one example of the way private investors' interests are disregarded.



**Talking of AGMs - why not come to UKSA's AGM next year?**

## **Policy Survey – DRIP's from Eric Chalker**

***It is often said that the best way of growing wealth is through dividend reinvestment. When this is done automatically, it can be both efficient and cheap. Some brokers provide such a facility, but only for nominee accounts, which doesn't help investors who prefer to own their shares. Some companies do provide such a facility (usually called a DRIP) for their own shares, but these don't get a lot of attention in the press (and are less valuable when using a personal - ie sponsored - Crest account because one can't pick and choose).***

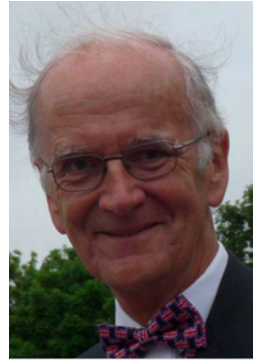
***I asked if you know of any companies which do offer DRIPs, or offer dividends in scrip form (ie shares instead of cash). There is a list of companies, details of which have been supplied to me. Space does not allow me to print the details here, but the table on Page 24 encompasses the information which your healthy response to my query has engendered. Thank you.***

## Prudent Accounting

The letter which follows was sent to the Financial Times in February. Roger Collinge was one of the joint signatories.

*Sir,*

***The European Commission will shortly opine on whether it feels our accounting system for publicly-listed companies – IFRS – has served the EU well. It is our view that there are serious shortcomings. The good news is that there are solutions that would be relatively straightforward to implement. Most importantly, prudence should be restored as the overriding accounting principle so that capital and performance are not overstated. The breakdown of realised and unrealised income should be visible to all.***



**Roger Collinge**

***These changes are not just vital for effective stewardship by executives, directors and shareholders, but they are necessary to bring the accounting framework back into line with existing legal requirements for capital protection as originally set out in the EU's 2<sup>nd</sup> Directive.***

***Evidence of problems with our accounting system is not hard to find. Whether it is hidden capital weakness in European banks (perhaps continuing today), directors paying out illegal dividends based on faulty accounts at Betfair plc, or the accounting games exposed at Tesco plc in September, it should be clear that – the audit problem aside – something has gone wrong with company accounts.***

***We believe the problem lies with the move in the EU to an accounting system (IFRS) that prioritises "neutrality" ("the absence from bias") over prudence. Prudence ensures that performance and capital are not overstated. This in turn underpins the confidence of shareholders and lenders in companies' balance sheet strength and capital stewardship. Without prudence, IFRS have relied more heavily on mark-to-market (MTM) to value assets and performance. With IFRS it is not possible to be certain as to what profits have been realised as cash, or what the capital position really is. This might seem like an esoteric point, but has far-reaching impacts for the public interest.***

***Most obviously, MTM gains on trading assets at banks fed an***

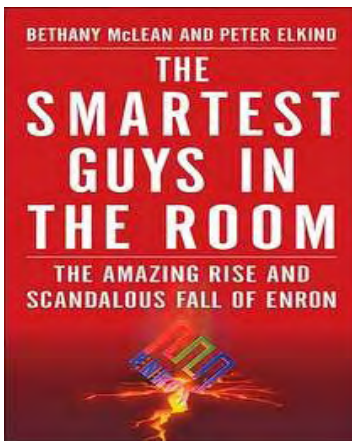
***exaggerated view of profits and capital prior to the financial crisis. This in turn helped to fuel an excessively risky lending boom. Ordinary people across Europe continue to count the cost of this period of over-optimism in the form of lower living standards. It is a fallacy to suppose that accounts merely provide a window onto the real world. They also shape reality by influencing behaviour.***

***And the damage is not limited to the financial sector, as highlighted by issues at Tesco. While aggressive accounting will be a problem with any set of standards (and requires robustly independent audit), the lack of prudence permitted by IFRS fuels uncertainty over what has actually been earned. This can, in turn, lead to inappropriate strategic and operational decisions.***

***The failures of our accounting framework need to be openly examined, and we welcome the EC's ongoing review. The accounting system remains one of the key unaddressed faultlines behind the financial crisis. The public deserves action.***

***Yours etc etc.***

(When you get to Page 17 you will see that there is an important message from Roger Collinge who has been co-opted onto the European stage).



On a separate but clearly related matter another letter to the Financial Times (but from different signatories) followed a few weeks later concentrating on mark-to-market accounting. Is it about time we lay investors had another update on this argument? Like John Hunter I read the book which took the scalpel to the affairs of Enron (*The Smartest Guys in the Room*). If there are investors that still make a case for mark-to-market (or model-to-market) I for one would just like to hear it.

***Bill Johnston***

## Foreign Kickshaws

by *Bill Johnston*

### BNY Mellon

The world's largest global custody bank by safe custody assets, the Bank of New York Mellon, has been fined £126m by the UK's regulator, the Financial Conduct Authority (FCA), for breaking rules designed to protect more than £1tn worth of assets held on behalf of UK-based clients.

The bank stands accused of "failing to implement adequate organisational arrangements for safeguarding client assets" and ignoring rules published by the FCA in 2010 aimed at protecting client custody assets in the event of insolvency by keeping what are known as "entity specific records".

Regulations obliging custodians to keep specific records about each client and their assets and accounts are in place to help an Insolvency Practitioner identify who owns which assets and ensure for these to be returned to them as quickly as possible.

BNY Mellon failed to keep clients' money separate from its own funds and used global platforms to manage clients' safe custody assets instead, making it impossible to maintain books and records on an entity-specific basis. More worryingly still, some clients' assets lodged in omnibus accounts, were being used without consent to settle other clients' trades, highlighting once again the continued issue in terms of shareholder rights for those investors **whose shareholdings are stuck in such nominee or omnibus accounts (!)**

### Deutsche Bank

Deutsche Bank, one of Europe's largest investment banks, is making headlines again. As one of the most highly leveraged banks in Europe at the beginning of the crisis, the bank has been subject to continuous scrutiny by the press, seeing the bank's persistent failure to adequately deal with the fallout of regulatory fines and address its chronic undercapitalization.

Now Germany's largest association for private investors and Better Finance member <http://www.betterfinance.eu/membership/member-organisations/#germany> organization, the Deutsche Schutzvereinigung für Wertpapierbesitz or DSW <http://www.dsw-info.de/>, is taking the bull by the horns in the name of the banks private investors by requesting the appointment of a special auditor to investigate whether the management and supervisory board of Deutsche Bank violated their legal duties and thereby harmed the company.



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On the one hand, DSW is calling for an external special audit into the adequacy of the reserves established by Deutsche Bank in view of the risks deriving from all the ongoing legal and supervisory proceedings against the bank. At the very least the special audit should cover the 20 largest legal proceedings against the bank, including the international investigation into the manipulation of interbank offered lending rates, also known as the LIBOR <http://www.bloomberg.com/news/articles/2014-08-03/bafin-extends-deutsche-bank-libor-investigation-spiegel-says> scandal.

On the other hand, the audit should look into whether all necessary preparations and precautions are taken in terms of compliance with the outcome of the legal proceedings, in order to identify and avoid similar cases in the future.

DSW added this request for a special audit to the agenda of the Deutsche Bank's annual general meeting of 21 May 2015, in order for the bank's shareholders to be adequately informed about the established reserves that are necessary to ensure the bank's future profitability. Shareholders who would like to support DSW's proposals should contact DSW directly via [dsw@dsw-info.de](mailto:dsw@dsw-info.de).

For more information, please consult the agenda [https://hauptversammlung.db.com/en/docs/HV2015\\_Agenda\\_Extension.pdf](https://hauptversammlung.db.com/en/docs/HV2015_Agenda_Extension.pdf) of Deutsche Bank's annual general meeting.

***Recently a fresh opportunity has arisen to be involved with a part of the European Securities and Markets Authority regulator based in Paris and known by the acronym ESMA. We consider it a singular mark of approbation that our own Roger Collinge has been invited to join this important body.***

ESMA's website says its mission is to enhance the protection of investors and reinforce stable and well-functioning financial markets in the European Union. ESMA, as an independent EU Authority, says it achieves this mission by building a single rule book for EU financial markets and ensuring its consistent application and supervision across the EU. It has a division which deals with reporting and a part of that division has what it calls a Consultative Working Group. Roger Collinge has been appointed to that Group and we regard this as good opportunity to further our agenda in a new forum, this time European.

Roger is keen to hear of any contact any member may have had with ESMA and also of any comments members may like to make. Please contact him at [uksa@uksa.org.uk](mailto:uksa@uksa.org.uk).

## **The Flash Crash Culprit**

**By Bill Johnston**

Here comes a twofold lesson for all investors whether of the type who with pursed lips tap out arcane ratios derived from ultra-sophisticated balance-sheet analysis and weigh their findings against plotted graphs of historic share prices or those that, blindfolded, stick a pin into the appropriate page of the Financial Times.

The first lesson is this. Buy some online software!

Fellow-investor **Mr Sarao has been arrested by Scotland Yard's Extradition Unit**. The US Department of Justice (DOJ) is seeking to extradite him to stand trial in Illinois, the home state of the Chicago Mercantile Exchange (CME), the **biggest futures exchange in the US**. **He's charged with one count of so-called 'wire fraud', 10 counts of commodity fraud, 10 counts of commodities manipulation and one count of 'spoofing', a form of market manipulation that involves placing a futures order and swiftly withdrawing it before the order is fulfilled**. If found guilty, he could be sentenced to up to 358 years in jail, roughly in line with a multiple murderer (Illinois abolished capital punishment in 2011).

The DOJ asserts that Mr Sarao used a modified off-the-shelf automated trading programme to manipulate the market for S&P 500 futures contracts over a 5-year period, making about \$40 million profit in the process.

The allegation is that he was sending spoof orders to sell futures contracts in the US stockmarket. He would drive the price of the stock down then withdraw the sell orders, but the price would already have fallen. He would then buy the orders back and guarantee a profit for himself. According to the charge sheet, he did this thousands and thousands of times over many years. This is an amazing insight into the way computers have totally transformed the Investment scene

**Of course \$40 million isn't what it used to be, and the risk of spending 358 years in a US prison will put the frighteners on many, but still....**

The second lesson concerns the deal that investors are getting, private investors in particular.

**The DOJ goes on to say that Sarao's alleged manipulation contributed to a major drop in the US stock market on May 6, 2010** Remember what happened on 6 May 2010? That was the day of the event that has gone down in financial

history as the Flash Crash. In the mayhem that ensued, the Dow Jones index lost 700 points in minutes, wiping around \$0.8 trillion from the value of US shares. The price of blue-chip US shares such as General Electric and Accenture crashed momentarily to as low as one cent, resulting in thousands of trades being cancelled retrospectively. **It's alleged that Sarao's market manipulation** provoked other automated trading programmes to pick up his trades and hence the mayhem.



**Bill Johnston**  
**Editor**

There is of course abundant evidence of manipulation of prices in favour of market makers, the most recent being on the very day on which this article is being drafted

Four US regulators and the FCA levied \$5.7bn in fines directly for manipulating foreign exchange benchmarks. Additionally, UBS and Barclays were ordered to pay \$263m to the Department of Justice because their activity violated agreements signed when the banks were fined for Libor rigging.

Barclays, RBS, Citigroup and JP Morgan also took the unprecedented step of pleading guilty to conspiring to fix prices, while UBS, which co-operated with the US investigation, pleaded guilty to a separate charge of wire fraud related to Libor.

Speaking personally, I mostly just accept such goings on as mere pinpricks given the conveniences which stock markets in particular and free markets in general provide. But I must admit that there is one thing which flicks me in the raw. It happened famously on 6th May but that is only the headline case; it inflicts regular damage on my finances and I am not disposed to swallow it automatically as a mere pinprick. And it is this.

I use the stop-loss system as a matter of prudence, for I cannot know everything and am prepared in effect to pay a price for insurance. I know that this means that, say, prolonged selling pressure perhaps based on faulty judgements might strip a perfectly good stock from my portfolio. That is an acceptable risk if for no other reason than the seller might well have the better case.

What I do not like are savage downward spikes of short duration, with no published news of any kind to give an explanation, almost as though they were designed to flush me out. There is never any news afterwards either. Am I paranoid? Does anyone else share this experience?

**Bill Johnston**

## Corporate Governance

*(Earlier this year the Financial Reporting set out its immediate priorities and invited comments. What follows is the formal response of the UK Shareholders' Association, which we hope to follow up as the year progresses. It was sent in February. This important contribution was held over from our last issue).*

We are broadly supportive of the FRC's proposed priorities, but wish to draw attention to three matters of specific concern to us, where we see the need for specific action. These were all mentioned during the open meeting, but we are now responding to the invitation to submit comments by email.

### High quality corporate governance

In seeking to influence development of the Shareholder Rights Directive, the FRC should be aware that, without a change in terminology, improving or granting more shareholder rights will have no effect at all on the fifty per cent **or more of this country's private investors who find themselves, not always by choice**, in broker-provided pooled nominee accounts. This is because, uniquely in the UK, the law does not recognise such investors as shareholders and they are consequently not entitled to any shareholder rights, only to subsidiary rights provided by the stockbroker, these often being limited to beneficial rights, namely dividends (for which they may be charged a fee) and the sale value of the shares.

The FRC should have a direct interest in securing the enfranchisement of these would-be share owners, in the interest of improving corporate governance and investor stewardship, because those deprived of an automatic right to information, the right to be heard and the right to vote, have no influence. Yet, by definition, these are investors with their own wealth at stake and there is no more powerful incentive to ensure that corporations to which it has been entrusted are acting appropriately for the **owners' benefit**.

The Shareholder Rights Directive must be amended to extend to what are **often described as 'end investors' the full rights intended for those described in the draft directive as 'shareholders'**, in order to make the Directive as applicable in the UK as it is expected to be in other member states.

## High quality corporate reporting

In seeking to improve the quality of corporate reporting, the FRC should add to its desire that it should be “fair, balanced and understandable” the objective of visual clarity, because far too many company reports are produced with fancy designs and small print that make readability too difficult, whether on screen, printed at home or printed professionally.

**Annual reports should be published primarily for the benefit of a company’s owners – its members, not for potential customers of the business or to look good when displayed in the board room or reception area.** Pictures should not be given precedence over text and all text should be readable without difficulty but especially in the narrative sections of reports. Nothing is more readable than black print on white paper, so proposed departures from this standard should be examined critically by directors before authorising them.

When private investors are repeatedly urged to save the planet by reading reports on screen, or by printing reports at home, they cannot escape wondering why so much effort and expense is thought to be justified in making reports difficult to read on screen (columns are particularly unfriendly) and full of expensive-to-print-domestically coloured content which does little if anything to improve understanding of how the directors have managed the business.

## High quality audit and confidence in its value

In seeking to improve investor confidence in auditors (which has a long way to go for private investors), the FRC should press for the reintroduction of an **automatic auditor’s representative to be present at AGMs and insist on a readiness to answer members’ questions which is often lacking.** The introduction of some emphasis on the work of audit committees has been helpful, but, despite appearances to the contrary, auditors are appointed by and paid for by the members so should not seek to hide behind the directors whose conduct of affairs they are supposed to oversee.

***Submitted by Eric Chalker  
Policy Director  
UK Shareholders’ Association***

## Letters to the Editor

Dear Sir,

I read the article by Charles Breese (*Our First Home Branch, March 2005*) with a great deal of interest. I totally agree with every word he wrote, especially the comment he made about his son. As a retired lecturer I saw standards decline over the years to accommodate ever increasing numbers and government pressure to award better grades. Employers primarily want experience and only offer graduate training schemes to those graduating from top universities.

As an investor I would love to invest in innovative early growth companies that require nurturing, but there is a major problem. Most of these companies are set up using the Enterprise Investment Scheme, which is being used to systematically fleece investors. Often original shares of £1 are subdivided into shares of 0.1p, where the sponsor pays 0.5p per share and the general public pay 3.0p a share, thinking they are getting a good deal because of the tax relief. A few years ago I was invited to invest in a company who were going to make six British films; if one of these films turned out as good as 'Four Weddings and a Funeral' then investors would make a return of 18%. That looked good until you calculated that for an equal investment the directors' return would be close to 600%.

There are plenty of investors out there willing to invest in small innovative companies. We appreciate that entrepreneurs with innovative ideas should get a better return than ordinary investors; all we ask for is a fair deal.

**Malcolm Howard**

Dear Sir,

It may be worth advising members that Alliance Trust Saving is to take over Stocktrade, a Brewin Dolphin subsidiary and maybe this is brought about by the management challenge Alliance Trust PLC has encountered in recent times from an major shareholder in the company. All just a thought worthy of some appraisal.

**R.D.V. Kite**

## Regional Information

***These events are open to members from all regions, and their guests, unless otherwise indicated. For 'waiting list' events all places are taken but there is a waiting list for cancellations.***

### **LONDON & SOUTH-EAST**

All events must be booked in advance via the specific organiser. Future events are shown in this magazine and on the UKSA website. Members from other regions are very welcome. For more information please contact Harry Braund on 020 8680 5872 or email [harrycb@gmail.com](mailto:harrycb@gmail.com)

Within this region there is a separate Croydon and Purley Group which meets in Croydon, usually on the second Monday of each month, at the Spread Eagle pub, next to the Town Hall. Please contact Tony Birks on 01322 669 120 or by email [ahbirks@btinternet.com](mailto:ahbirks@btinternet.com), who will confirm actual dates. There is no charge and no booking necessary.

### **MIDLANDS**

For general information, contact Peter Wilson 01453 834 486 or 07712 591 032 or [petertwilson@dsl.pipex.com](mailto:petertwilson@dsl.pipex.com)

At the present time no meetings are being arranged specifically for the region, but members are cordially invited to attend meetings in the North or South West regions where they will be made very welcome; or indeed London if that is more convenient.

### **SOUTH-WEST AND SOUTH WALES**

All South-West events must be booked in advance, and are open to all members and their guests subject to availability.

**Didmarton:** The King's Arms, Didmarton: cost is £22.50, including coffees and lunch. Events are at 10 for 10.30am. To book, contact Peter Wilson 01453 834 486 or 07712 591 032 or [petertwilson@dsl.pipex.com](mailto:petertwilson@dsl.pipex.com)

### **SCOTLAND & NORTH-WEST**

Volunteers sought

### **NORTH-EAST**

Advance notice is required for all company visits and lunches. Knaresborough: venue is the Public Library, The Market Place, Knaresborough. For more information (except where stated otherwise), please contact Brian Peart, 01388 488419 or Julian Mole at [Julian.mole@btinternet.com](mailto:Julian.mole@btinternet.com).

## Automatic Reinvestment of Dividends

We recently asked members, by email, to tell us of companies which either offered automatic dividend reinvestment or scrip dividends. 23 replied and gave us the following list, some of which was said to be based on old records so may no longer be true.

<i>Albion Development</i>	<i>Home Retail</i>	<i>Rio Tinto</i>
<i>VCT</i>	<i>HSBC</i>	<i>Rolls-Royce</i>
<i>Aviva</i>	<i>Imperial Tobacco</i>	<i>SSE</i>
<i>Banco Santander</i>	<i>International Consolidat-</i>	<i>Segro</i>
<i>Baronsmead VCTs</i>	<i>ed Airlines Group</i>	<i>Royal Dutch Shell (A</i>
<i>Barclays</i>	<i>Interserve</i>	<i>shares only)</i>
<i>Bellway</i>	<i>JP Morgan European IT</i>	<i>Standard Chartered</i>
<i>BP</i>	<i>Kingfisher</i>	<i>Standard Life</i>
<i>BT</i>	<i>Legal &amp; General</i>	<i>Temple Bar IT</i>
<i>Burberry</i>	<i>Lloyds Banking Group</i>	<i>Tesco</i>
<i>Centrica</i>	<i>Marks &amp; Spencer</i>	<i>The Scottish IT</i>
<i>Compass</i>	<i>National Grid</i>	<i>Unilever</i>
<i>Croda International</i>	<i>Pennon Group</i>	<i>Whitbread</i>
<i>Eco Animal Health</i>	<i>Raven Russia Preference</i>	<i>Wm Morrison</i>
<i>Group</i>	<i>Reckitt Benckiser</i>	<i>Witan IT</i>
<i>Experian</i>		
<i>GlaxoSmithKline</i>		
<i>Hays</i>		

Very few members appear to take up these offers, although scrip dividends (ie new shares) are favoured because of price and tax advantages. A number said they don't because it adds to record keeping and can be a problem when accounting for CGT or wanting a quick sale. Others complained about the cost of merging the accumulated certificates as charged by registrars, although a direct approach to the company secretary generally produces a better result.

**Eric Chalker**