UKSA
UK Shareholders' Association

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Responding to the Financial Conduct Authority

UKSA's Policy Team spent much of November and December preparing a 56-page response to the Financial Conduct Authority's Call for Input on the Consumer Investments Market.

We felt it vital to make our voice heard. The issues raised go to the heart of what UKSA stands for.

First, we welcomed the clear recognition in the Foreword to the Call for Input that there is a problem – namely that there are suitable and inexpensive products, but people do not use them enough. Adding to the problem, firms are not generally keen to promote those products.

The main problem is costs to the consumer. Very little of significance has been done to tackle the conflict of interest between financial service providers and their customers. The power of the financial lobby acts to prevent progress and innovation in this regard.

The job of helping people to make the best choices with particular regard to the long-term impact of costs is not one for which we detect much appetite in providers, the FCA, other financial regulators, or in the Money and Pensions Service.

One of the FCA's "principles of good regulation" is the general principle that consumers should take responsibility for their own decisions. We support this. But consumers need ready access to the fundamental truths about investment, freely shared by disinterested parties with a public interest motivation. Competition will not work for consumers without this.

It is also vital to recognise the diversity amongst consumers. At one end of the spectrum, it is important that the FCA does not introduce heavy-handed solutions that restrict market access for knowledgeable and well-informed, or sophisticated, individual investors in the mistaken belief that such restrictions are essential to protect the majority. But whilst we believe that there are benefits for society in more people taking an interest in investment, we must recognise that the majority of people are at the other end of the spectrum from sophisticated investors, and are vulnerable to exploitation, inadvertently as well as advertently, even if the FCA does not class them as "vulnerable".

We believe it is time for individual savers and investors to help themselves and each other to identify and support the best-value solutions. They should be encouraged to become actively involved in meeting the country's challenge of improving financial capability. The FCA should ensure that its regulations support this.

We believe that this enquiry is enormously important in ensuring that much-needed and meaningful change is achieved in the consumer investment market.

The Policy Team

In this issue

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UKSA's response to the FCA's Call for Input on the Consumer Investments Market

UKSA submitted a 65-page response to the FCA's consultation.

The bulk of the document comprises answers to the 38 detailed questions posed by the FCA. These can be found in the full response posted here on the UKSA website.

The introduction below highlights the main points.

There is a problem, which arises from the big power imbalance between providers and consumers. Consequently the market runs largely in the interests of providers of financial services, not in the interests of consumers.

The game is heavily stacked against ordinary people due to the deep conflict of interest between financial service providers and consumers, and the fact that most consumers, below those that are knowledgeable and well informed on the spectrum, lack the knowledge to assess what is, or what is not, good value. The FCA's research work over the years has forcefully demonstrated this; the FCA's excellent asset management market study is a good example. The problem is not limited to the retail investment market; the 2013 study commissioned by the Department for Communities and Government into the investment of local government pension schemes identified huge potential savings achievable by moving from an active to a passive strategy.

We find Chris Woolard's Foreword to the CFI particularly encouraging, in that it acknowledges that there already exist "readily understood, well-diversified and low-cost investments", yet most people do not use them. This is not surprising; the industry makes more profit by promoting expensive and complex products, and by promoting the message that finance is too difficult for consumers to understand by themselves. Whilst always well-intended, we suspect that the regulatory regime may, if anything, have unintentionally given cover to this message.

Today's competition between market providers does not serve consumers' interests, because providers have much deeper knowledge and understanding of their products and their potential drawbacks. We believe that Chris Woollard's Foreword acknowledges this.

We would suggest that within that foreword there may be the germ of at least a partial solution. The FCA is clearly well able to identify which individual products are "readily understood, well-diversified and low-cost investments". But people need to be pointed to such products without needing to go to an IFA. Our understanding of the regulatory regime is that it makes it extremely difficult to share information of this nature, a situation which we regard as supportive of the status quo and not in the public interest.

Our initial thought was this: why should the FCA not publish details of these products with explanations, including explanations of how the costs operate, on the FCA website? But on reflection, we understand why the FCA and its predecessor have always been resistant to recommending individual products since there would be a reputational risk if a recommended product underperformed for some reason.

Might there be a way round this? The FCA could describe classes of products and services that in their view met the criteria of "readily understood, well-diversified and low-cost investments", explain why they met these criteria, and encourage the publication of costs for individual brands. We use the term "FCA criteria" in this document to refer to the characteristics of readily understood, well-diversified and low-cost investments.

The FCA should have the power and the appetite to interpret its strategic objective to ensure relevant markets function well as trying to get those markets to operate in the best interests of consumers.

The FCA has to pursue its objectives as set out in statute. Reproduced below is the relevant part of FSMA 2000 after amendment by FSA 2012:

> 1B The FCA's general duties
>
> (1) In discharging its general functions the FCA must, so far as is reasonably possible, act in a way which —
>
> (a) is compatible with its strategic objective, and
>
> (b) advances one or more of its operational objectives.
>
> (2) The FCA's strategic objective is: ensuring that the relevant markets (see section 1F) function well.
>
> (3) The FCA's operational objectives are —
>
> (a) the consumer protection objective (see section 1C);
>
> (b) the integrity objective (see section 1D);
>
> (c) the competition objective (see section 1E).
>
> (4) The FCA must, so far as is compatible with acting in a way which advances the consumer protection objective or the integrity objective, discharge its general functions in a way which promotes effective competition in the interests of consumers.

How does the FCA interpret its strategic objective of "ensuring that the relevant markets function well"? Our concern is that the FCA has not seen that as identical to getting the best outcome for consumers. Yet we consider that it is open to the FCA to interpret "ensuring that the relevant markets function well" in precisely this way. And we detect an increasing acknowledgement in FCA publications, culminating in the Foreword of the CFI, that the current system does indeed give poor outcomes for many consumers.

It is clear that the FCA have long understood the impact of expenses on consumer outcomes. Yet the power of the financial services lobby makes us doubt that the FCA will ever be permitted to tackle the problem properly. We also recognise that the Government sponsors the Money and Pensions Service (MAPS), which gives good information about basic financial management, and which has a major emphasis on managing debt. But the existence of the MAPS does not currently tackle the conflicts and the consumer disempowerment in the long-term savings market. We also note that in MAPS' 2020-2030 UK Strategy for Financial Wellbeing a search for the word "fee" does not find a single hit; the same is also true of the word "charge" and the word "expense". The word "cost" appeared in the context of the cost of credit, but not that of investment costs.

The FCA's own Financial Services Consumer Panel (FSCP) has long taken an interest in the question of costs, and the position of consumers vis-à-vis the industry. Quoting from an FSCP discussion paper from around 2015 "Investment costs – more than meets the eye":-

> "The evidence reveals a market characterised by a weak demand side that is rapidly growing numerically, and a powerful industry in which misaligned incentives are systemic and which enjoys, largely unchallenged, the potential to exploit consumer behaviour, product structure complexity and the lack of cost transparency. As such, the Panel believes that this is not a market where competition works in the consumers' best interests."

The FSCP paper also explains that the effective total costs suffered by investors in managed funds, especially active funds with high turnover, can be materially greater than the explicit charges quoted by the managers.

The impact on consumer outcomes of costs involved in the investment chain is much greater than most people would appreciate – this is the process of (negative) compound interest at work. Cutting the annual costs suffered on a lump sum by 1% over a period of 30 years would improve the final capital sum by over one-third. Over a 51-year period, it would improve the outcome by just over two-thirds. And the difference between the cheapest solution and the typical retail product may be well over 1% per annum, even before any IFA costs. So the benefits for consumers of shaving what may look like "a small percentage" per annum from the expenses they suffer are huge. The claim one often hears that "performance matters more than charges" is a smokescreen – the impact of expenses is predictable, performance is not.

Of course there is another side to this story. It is the profits and high pay within the financial services sector. Therefore, it needs to be recognised that much better outcomes for consumers that will result from their being empowered and supported would mean less wealth is extracted by the financial services sector.

The truth is controversial when it threatens livelihoods. Solution:

An independent voice is needed to tell the full truth about expenses, especially the importance of minimising annual percentage charges, or avoiding them altogether; and

Empower people by pointing out the simple good-value products and services they can actually use, that do not normally need the involvement of a financial adviser.

Given that the financial services sector will never provide the information consumers need in a disinterested way, there is a huge void in trust that needs to be filled. Can the FCA fill the void? Who are consumers to trust?

We believe that savers and investors should be allowed to voluntarily help each other. What we ask of the FCA is to remove the existing regulatory blocks in the way of this process.

This is our main point in response to Q1 below and to the last but one paragraph of the Foreword. We would want to be confident, for example, that we could mention by name particular providers as being especially low cost, and to explain the benefits of, for example, self-select ISAs that just charge a modest fixed fee, in which you can purchase a low-cost well-diversified passive ETF, on which the ISA provider does not make an annual percentage charge.

The UK Shareholders' Association has for some time been working on an initiative that we call "Savers Take Control". This is an entirely voluntary attempt, involving knowledgeable investors who are not conflicted by being financial services providers, and who want to do something useful for society as a whole, to tackle the causes of declining public respect for the entire wealth creation process. More information on Savers Take Control is given in the Appendix opposite. UKSA also has a freely available financial training site we call "honestmoneynow".

Resolving the expense problem is not enough. There are other important truths about investment, relating to fundamental uncertainties and how to manage and live with them.

In the article on page 10, we set out a brief discussion of the kind of basic but essential, empowering information that everyone needs to have readily available. All of the behavioural research on consumer decision-making has been in the context of the current situation where there is no easy answer to the question "who do we trust". But if such essential information were widely available, trusted and discussed, we believe this would lead to a gentle revolution towards a more financially engaged and aware society, with huge benefits for future generations.

Essential information includes not only helping people face up to uncertainty but also understanding the negative compounding implications of debt and expenses, as well as the positive compounding effects of investment returns.

The problem of financial education is a long-term one with no quick and easy solution. It needs a step change in approach across many agencies, not just regulators.

It is all too easy to talk about education as a simple solution to the problem of financial capability. But there is no quick solution, and it is not just about educating the young, important as that is. A step change in national approach to financial education is called for at all ages. Our understanding is that levels of financial education as well as numeracy are relatively poor in the UK. On the plus side, there are a number of bodies, including charities, outside the official sector with a brief to help with numeracy, financial capability and many other aspects of personal development. Such bodies should work together, and there may be a role for the FCA in encouraging this. It would also need representative consumers to come forward to get involved, so that we can collectively discover what works. This would be an exciting exercise to be part of. But it would be vital to ensure that the financial sector was not given the opportunity to influence the discussion or the messages.

At the same time as expressing concern about general levels of financial education it is also important to recognise that there is a wide spectrum, in terms of the depth and sophistication of people's financial knowledge. And for people who are interested to learn for themselves, there are plenty of resources available. There is also mutual support available from our organisation for those who wish to engage with us. Our experience is that people with an interest in investment often enjoy sharing knowledge and learning from each other.

Whilst the protection of the majority is vital, it would be inappropriate to put regulatory measures in place that failed to recognise the diversity of investment knowledge and experience and, as a result, restricted market access for knowledgeable and well-informed (sophisticated) individual investors.

On a wider canvas the whole principle of protecting the public by regulating the supply of advice has had the unintended consequence of denying savers access to the support of their employers, pension administrators, local authorities, low-cost professional helpers and even qualified friends.

Another unintended consequence is imposing costs on all consumers to provide something which some consumers do not need. One example is where providers are required to send specified information at regular intervals to consumers, with an associated charge for sending the information. A specific case is projections of the future value of a SIPP. While many consumers are unable to compute this for themselves, those consumers with appropriate knowledge can, yet they are forced by regulation to pay for the supply of these projections by their provider.

We have worked closely with ShareSoc in drafting our respective responses. However, we have some differences of scope, perspective, and emphasis; hence the separate submissions.

We believe that this enquiry is enormously important in ensuring that much needed and meaningful change is achieved within the consumer investment market. We would be very pleased to provide further feedback either orally or as further written evidence.

Appendix: Savers Take Control

by Martin White

Savers Take Control (STC) is an ambitious, early-stage, but very simple idea for altering the balance of power in relation to individual investment. It is a not-for-profit project which relies on knowledgeable investors putting time and effort for free into helping less knowledgeable investors. The intention is for STC to develop into a well-known and trusted voice that can be relied on to be completely independent of both the financial and the corporate world.

The STC team is currently largely composed of people who are retired, having previously worked in various parts of the financial sector. But we would be delighted to hear from anyone, whatever their skills and experience might be, who has an interest in investment, who meets the independence criteria above, and who has a passion for tackling the imbalances we discuss in this submission in the interests of our society as a whole. The balance of power has tipped further away from individuals and towards the financial services market. At the same time individuals are expected to be more self-reliant, with the demise of generous company pension schemes.

It's not just the savings chain that we wish to influence, however. There is also the "ownerless corporation". In our response to Q38 of the CFI, we give a link to a lecture by Lord Paul Myners on short-termism, that explains how he came to realise that many, if not most, companies operated without effective governance by their owners. A consequence of this is the explosion in executive pay. But if you raise the topic of executive pay in the corridors of power, and certainly in any discussions in the City of London, the discussion is immediately moved on to something else. So as well as independence from the investment sector, we are also determined to be able to speak out to argue for a completely different approach to executive pay. As savers and investors, we ought to be able to ask those who manage investments for us to require the companies we own to improve their behaviour. Unfortunately, it is hard for well-paid fund managers to crack down on executive pay in companies that they own on all our behalves.

A number of articles and presentations, as well as contact information, can be accessed at

www.uksa.org.uk/Savers_Take_Control.

Here are the titles of some of the articles you will find in the February 2020 and June 2020 issues of UKSA's Private Investor magazine:-

Time to engage the voice of the individual in a national debate

Changing the world of savings and investment and driving a change in company behaviour

John Kay on remuneration

What does a corporate culture feel like when nobody worries about the share price or what profits are reported this quarter?

Improving capitalism for the public good – what do we have in mind? And can it be done?

The magic ingredient: Savers and Investors helping each other for free – would you like to help?

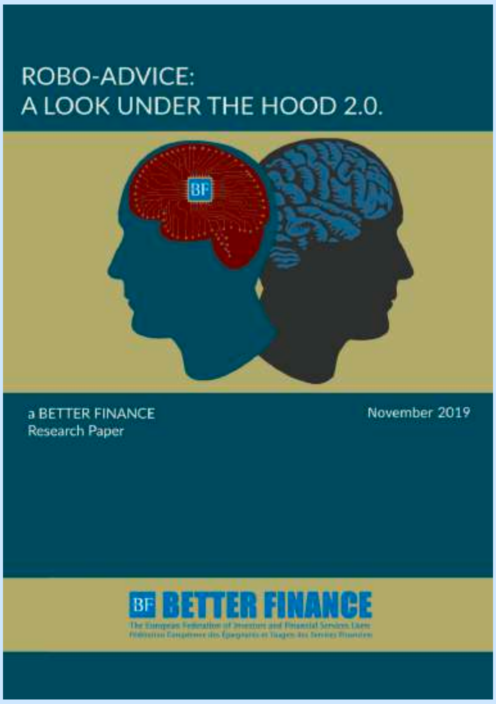
Robo-Advice

Our submission to the Financial Conduct Authority included the subject of Robo-Advice, whereby financial advice is provided on an automated, algorithm-driven basis with little or no human supervision. The automated advisor requests data through an online survey and then proposes matching products in which to invest the client's funds.

The attraction is of course low fees. But does it stack up in practice?

Better Finance, the European body that promotes the rights of savers and investors, has conducted annual surveys on this industry from the perspective of individual savers and investors. The latest edition surveyed 16 platforms: 11 from EU countries and five from North America. Year-on-year comparisons are included to track the evolution of these platforms in the market.

Robo-Advice: A look Under the Hood 2.0 is available here as a free download.



Lifting the Lid on the FRC – virtual edition

Continuing a process initiated last year at UKSA's request, the Financial Reporting Council held five “Lifting the Lid on the FRC 2020” virtual meetings on consecutive afternoons to discuss issues of concern to private investors.

These were attended by invitation by UKSA and ShareSoc members. They were held each afternoon in the week beginning 23 November 2020. They covered 1) Corporate Reporting Review and the UK Endorsement Board, 2) Audit, Reporting and Governance Authority (ARGA) Transformation, 3) Enforcement, 4) Audit Quality and Standards and 5) Corporate Governance and Stewardship.

The FRC, eventually to become the Audit, Reporting and Governance Authority (ARGA), is the overall regulator of UK corporate annual reports, which are probably the primary source of business and financial information for shareholders in UK plc. They have been criticised for not being tough enough and allowing some of the recent past corporate scandals to occur but are now progressing the recommendations of the Kingman and Brydon Reports that they do not need legislation for. Last year's and these meetings are a reflection of the increasing attention being paid by regulators to the views and needs of private investors and their importance to the governance of companies.

Stop Press - the EU-UK trade deal

The EU-UK Trade and Cooperation Agreement has landed and like many organisations we are poring over the detail to discover what it means for business, investors and financial service providers.

As has been widely trailed, there is little provision for cooperation in financial services. That is why banks and other providers have been withdrawing services to cross-border residents. It was in anticipation of this that many institutions spent the last four years creating new subsidiaries where necessary to trade in each other’s territory. Nonetheless, some of the details included in the deal will negatively impact cross-border services, particularly the lack of recognition of qualifications and restrictions on the length of stay in each other’s territory during business trips.

We look forward to clarification from both sides in the next few days as well as indications of subsidiary agreements that might provide greater clarity.

Consultations

UKSA is involved in a number of consultations, sometimes as lead author, sometimes as key contributor. Each month, we are completing, in the process of or beginning responses to the consultations. Here is a 'round-up' in no particular order. If you are interested in getting involved in open items, please contact David Riches at admin@uksa.org.uk. Thank you to Sue Milton for compiling this information.

Consultation	Submission date	UKSA's response progress	Information available at:
LINKGroup on the AGM in 2020 – a survey of shareholder views.	November 2020.	Completed.	Jai Baker FCIS on LinkedIn: Survey Results
IFRS launches consultation on developing sustainability standards via a Sustainability Standards Board.	31/12/20.	Completed. Response is on behalf of the CRUF (the Corporate Reporting Users Forum).	IFRS - IFRS Foundation Trustees consult on global approach to sustainability reporting
FRC's Lab on Section 172 Reporting.	October 2020.	Completed.	News I Financial Reporting Council (frc.org.uk)
The IASB's Discussion Paper on Business Combinations – Disclosures, Goodwill and Impairment (DP/2020/1).	31/12/20.	Completed. Joint response from UKSA and ShareSoc.	IASB publishes discussion paper on goodwill and impairment (iasplus.com)
Proposal to revise ISA (UK) 240 (Updated January 2020) The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements.	29/1/21.	Response, in draft, is on behalf of the CRUF (the Corporate Reporting Users Forum). A separate response will be drafted on behalf of UKSA.	News I Financial Reporting Council (frc.org.uk)
"A Matter of Principles", the FRC's discussion paper on the Future of Corporate Reporting.	5/2/21.	In draft.	News I Financial Reporting Council (frc.org.uk)
FCA's Call for Input on the Consumer Investments Market	15/12/20.	Completed.	This edition of TPI and Call for Input: Consumer investments | FCA
IAASB Fraud And Going Concern In An Audit Of Financial Statements	1/2/21.	Started.	Fraud and Going Concern in an Audit of Financial Statements | IFAC (iaasb.org)

Update on Unilever

Back in August we reported on Unilever's announcement of plans to move its Rotterdam headquarters to London. It would keep its main market listing in London alongside secondary listings in Amsterdam and New York.

Unilever had functioned as a dual company since it was formed in 1930, although it maintained that it operated “as nearly as practicable as a single economic entity".

Despite pressure from some shareholder groups linked to concerns about a mooted 'exit tax' in the Netherlands, the company was unified as a UK plc on 30 November.

For the first time the company's shares are now trading in a single pool of liquidity with shares in the Dutch NV no longer being traded. The plc shares are now included in the secondary listings as well as the main London listing.

The new UKSA newsletter

Members have recently received UKSA's first e-mail newsletter. We aim to provide faster and more concise news to supplement the coverage in The Private Investor.

Please let us know what you think.

HonestMoneyNow

Honest Money Now is UKSA's independent financial education website. It was originally developed by John Hunter.

It provides basic, unbiased financial education, from cradle to grave, and stands out from other sites in its emphasis on basic principles. Other sites teach the characteristics of financial products but leave users ill-equipped to choose between them.

The site's core message is that good financial habits are not difficult. They are only made to seem so by those with a vested interest in confusion. Whatever your level of knowledge, if you work through the lessons of this site:

- you will be able to manage your own affairs, and
- you will understand the need for good advice and will be able to look for it, and
- you will be able to recognise biased advice and reject it.

Editor's note: We're pleased to carry two contributions from Mohammed Amin this month. Although Amin is a member of UKSA's Policy Team, he writes for The Private Investor in a personal capacity. He is a retired PricewaterhouseCoopers tax partner.

How private equity executives pay less tax on their earnings than the rest of us

by Mohammed Amin
MBE FRSA MA FCA AMCT CTA (Fellow)

While it is always a mistake to look for logic in tax law (to paraphrase Donald Trump, "Tax law is what it is"), there are some general principles seen most of the time. For example:

- What you earn by actively doing things, whether blue collar work or white collar work, is subject to income tax, with rates currently running from 20% to 45%.
- When things that you own go up in value and you make a gain from selling them, that gain is subject to capital gains tax, with the rates being 10% or 20%. (The higher rates which apply to gains on residential property are not relevant for this article.)

When you work as a private equity executive, you do the same white collar work as many of us: reading things, attending meetings, writing reports, making phone calls, writing emails etc.

So how do you manage to pay tax on much of what you earn at capital gains tax rates instead of income tax rates?

I have set out a simplified illustration below. In practice, private equity funds usually have very complex organisation charts. I have ignored that to make the principles easier to understand.

A private equity fund is normally structured as a limited partnership:

- The limited partners are outside investors who supply most of the capital.
- The general partner is typically a company owned by the private equity house that has sponsored the fund. It normally provides some capital to the fund, but not necessarily very much.

The general partner is typically entitled to make two charges to the fund:

- An annual management fee of, say, 2% of the size of the fund.
- A participation charge, called "carried interest", whereby once the fund has achieved a specified overall rate of return, say 10% per annum, the channel partner is entitled to, say, 25% of the excess return.

The income from the annual management fee is used by the general partner to pay for the running costs of the private equity house. This includes the salaries of the employees who are the key deal makers. These salaries suffer regular income tax.

The key deal-making employees normally also have fractional ownership stakes in the general partner company, either directly or indirectly.

When the fund is eventually closed out at the end of its life, assuming it has been successful, on the above numbers 25% of the excess return of the fund will be in the form of cash inside the general partner.

When the general partner is wound up, the key deal-making employees will make gains on their shares since the general partner company is liquidated and the cash inside it is paid out.

The key question is what rate of tax should apply to the gain made on this liquidation.

There are many complicated rules in UK tax law applicable to shares which have some connection with your employment. These rules normally have the effect of taxing gains on such shares as ordinary income, where the top rate of income tax in the UK is 45% as stated above.

However, in the case of private equity and carried interest, UK tax law allows such gains to be taxed at the normal capital gains tax rate. That capital gains tax rate is currently 20% for higher rate taxpayers.

Accordingly, the continuation of this favourable tax treatment of carried interest, taxation at 20% instead of 45% at top rates, is of great importance to the private equity industry in the UK.

Their threat is that if the UK eliminates this favourable tax treatment, they will emigrate, just as sports stars tend to emigrate once they become successful. Whether or not they are bluffing is a political question which I cannot answer.

Personal finance 101 – advice for children and friends

by Mohammed Amin

For those unfamiliar with American English, part "101" of any college course aims to cover the absolute basics.

UKSA members of course don't need to learn personal finance 101; all of us should already know it. However, many have children, and most are also likely to have friends who occasionally ask for financial advice.

At that point, as well as the common-sense risk of giving advice that might turn out badly and lose a friend, the law severely inhibits what you can say to people without falling foul of financial services regulations.

With my own children, I operate on the basis that I can say what I want to them. If the law wants to get involved, I will take my chance to become a regulatory martyr!

However, with anyone outside the family I just have to say that I cannot help them, beyond suggesting some good quality reading material.

UKSA emphasised how current rules prevent the sharing of basic common-sense knowledge in its recent response to the FCA consultation on the Consumer Investments Market. As part of my collaboration on that response, I wrote down what I regard as the absolute basics of personal finance, which we should be able to share with anyone. Unfortunately, what the law stops us doing is naming any names of suitable products, even when the choices are obvious.

Below is what I wrote, which became the key part of Appendix 2 of the UKSA submission, since readers may wish to share this with family and friends who approach them.

The following points are numbered because they follow a strict order of priority:

1. Repay expensive debt, which would normally mean all debt apart from mortgages.

2. If you have any dependants, after considering employer-provided death cover, ensure that you have about 20 times your annual income in term insurance before you buy any other financial products.

3. If an employer pension scheme is available, join it.

4. Maximise your employee pension contributions up to the largest amount for which your employer will make matching contributions. Invest 100% of this in a global developed countries' market capitalisation weighted ETF (exchange traded fund), or the nearest equivalent out of the employer's scheme's investment choices. However, in the UK be aware of taxation's annual and lifetime limits.

5. After taking into account your confidence in finding other employment if you lose your job, and any other relevant family circumstances, ensure that you have the equivalent of several years' worth of essential expenditure, perhaps as many as five, in cash or near-cash before you buy any long-term investments such as equity or property linked investment products.

6. If you are young enough to qualify, the next step after the ones above should be to put your savings into a Lifetime ISA (individual savings account), invested in the same ETF as mentioned above.

7. Any further savings should be put into an ISA or SIPP (self-invested personal pension plan) subject to the limits allowed, with the choice of priority depending on your forecast of current and future tax rates. If in doubt about future tax rates, ISA first and then SIPP.

8. Be very aware of the importance of costs in investment, including the costs charged by providers such as investment platforms, the explicit costs of the managers of any collective investment funds, and the implicit cost that have to be met by collective investment funds including the costs of trading.

9. Unless and until you attain sufficient confidence to make judgements about company financial reports, business models and competitive environments, do not venture into individual company shares.

The AGM in 2020 – a survey of shareholder views

UKSA was approached by Jai Baker FCIS, Head of Industry at Link Group, Corporate Markets to take part in a survey on AGMs.

The objective was to understand how retail investors perceived the increase in the digital delivery of AGMs, how supportive they were of the holding of hybrid virtual meetings and how they felt this had impacted engagement with companies and directors.

The survey was live during November 2020 and the full report can be found here or by searching for Jai Baker FCIS on LinkedIn.

In case you missed it

– Primark estimates that recent lockdown has cost it £430 million in lost sales but it is still forecasting higher overall sales and profit for its full year ending Sep 2021 – Patricia Nilson Financial Times Dec 5th

– UK is set to suffer more economic pain arising through Covid19 than any other leading economy apart from Argentina, according to the OECD – Chris Giles Financial Times Dec 5th

– Canaccord Genuity's Tony Dwyer is bullish on the US market outlook for 2021 but in near term is expecting a pullback – Stephanie Landsman CNBC Dec 10th.

– Rishi Sunak's spending review will reveal government borrowing this year of £394 billion, a post-war record, with unemployment set to rise to 7.5% by the second quarter of 2021 – FT Money Nov 28th

– Influential report from the Wealth Tax Commission proposes a one-off wealth tax of 5% including primary homes and pensions on assets over £500,000 (£1 million for couples) to pay for the Covid 19 crisis.

– Unilever is to offer investors a regular vote on its plans to tackle climate change, becoming the world's largest company to do so.

– Vodafone has made a €2.1bn offer to buy out minority shareholders of Kabel Deutschland in an attempt to reduce its exposure to legal claims.

– A report by the Financial Reporting Council criticised UK listed companies of falling short in terms of diversity and treating reporting on culture and strategy as a box-ticking exercise.

Share Analysis Blogs for us all – Update on a Joint Educational Project

by John Mulligan

Following on from the article I wrote about share screening for the October issue of TPI I thought you might be interested to hear about the plans for a joint endeavour between UKSA and myself to create a series of regularly updated blogs and video blogs designed to stimulate the interest of younger people in the exciting and potentially profitable world of equity investment.

Encouraged by your able editor Helen Gibbons and the UKSA Board, I am in the process of drafting out the components of these blogs under the following headings:

The rationale for equity investment
The options available to UK residents
Guidelines for equity portfolios
Lessons from investment maestros
Sourcing data and
Ways of using screens to select shares and build portfolios.

The concept is to use these key themes to extend the awareness of UKSA and its activities to a much wider audience while also providing an interactive experience of a range of share analysis methods, including the STAR screens, to private investors who may wish to become more actively involved in selecting and managing their equity investments.

As it is planned to make these short guides as relevant and up-to-date as possible, the contents will be regularly reviewed and amended with suggestions and comments for improvement sought from all UKSA members. We shall keep you updated on the progress of this project through the medium of the TPI.

Capital Gains Tax simplification

by Roy Colbran

The suggestion by the OTS (Office of Tax Simplification) that capital gains tax rates might be aligned with income tax has, according to the FT, caused such concern that senior executives and company founders are rushing to sell their shares in the current tax year before new rates can come into force. So I thought it was worth looking at what the OTS actually say to see whether this activity is justified. The recommendation is, in fact, qualified by the phrase "If the government considers the simplification priority is to reduce distortions to behaviour". Since distortions to behaviour include efforts to convert or re-characterise income as capital, there seems every reason for Government to make this a priority. Then the actual wording is "more closely aligning" rates, which gives scope for the Chancellor to go only part way if he so chooses. The OTS tells us that on present patterns of reported gains equalisation could produce an extra £14 billion per year in revenue, but they warn that changes in behaviour would mean that nothing like this figure would be achieved. Moreover, with CGT rates at these levels the OTS see a strong case for reintroducing some form of inflationary gain relief and possibly some kind of averaging so that basic rate taxpayers are not pushed into the higher rates just because of a single year's gain. Thus there are just a few qualifications which might deter the Chancellor, but then there must also be the possibility of some of their other ideas, mentioned later in this article, being adopted. One can see why alarm might be warranted.

This report differs from the one the OTS did on IHT in that the Chancellor who commissioned it is still in place at the time of publication which presumably increases its chances of being followed up. It is only the first stage but covers key topics while the second early next year will deal with technical and administrative issues. In this article I will concentrate on issues affecting holders of portfolios of individual shares, such as UKSA members might have, and leave those who want to know about Share Schemes and Enterprise Relief to go to the paper itself.[1]

Private investors and CGT

The report includes lots of statistics, many of which are said to be newly in the public domain. The latest year for which firm figures are available is 2017-18 and in that year individuals paid £8.3 billion in CGT on net gains of £55.4 billion. This compares with £180 billion from income tax. The figures show clearly that the major part of CGT collected comes from single large transactions such as sale of property or business and the amounts collected from share portfolios are a relatively small proportion of the whole. Of gains reported by individuals more than one half come from those reporting totals in excess of £2 million in a single year and over one-third from those in excess of £5 million.

The evidence that UKSA and ShareSoc submitted jointly highlighted the fact that private investors often cannot rebalance their portfolios without paying CGT unlike the position of collective investment vehicles. They also drew attention to many of the difficulties and complexities in making correct calculations. With no simple solution to these problems in sight, our gallant team was seduced into devoting a lot of space to an elaborate idea involving the creation of yet another special investment vehicle. I am afraid this has no chance of being taken seriously. Perhaps this is why the rebalancing problem is not mentioned in the report. I think we have to remember in protesting our position that we have the benefit of ISAs which are extraordinarily generous to individual shareholders and, of course, freely facilitate rebalancing.

For people with relatively modest direct portfolios the annual tax-free limit at its present level is, of course, helpful to a degree in rebalancing. However this is one thing that the OTS very clearly see as excessive. They are well aware that reducing the limit would result in a drastic increase in administration. For example, to reduce it to £2500 would result in 360,000 more individuals having to report a capital gain, although this does not allow for the changes in behaviour which would inevitably result from such a reduction. Nowhere in the report do they mention, or throw any doubt upon, the extent of compliance with the present reporting requirements apart from a hint where they say that gains on chattels are rarely reported. I would have expected a reduction like this to leave many people not even aware that they should be reporting a gain.

In this connection the report highlights the fact that every year, in looking at the individual amounts of gains declared, there is an enormous spike in the bracket £1000 below the annual tax-free limit. Where no CGT is payable gains only have to be reported where total disposals exceed four times the annual tax-free limit and where the individual is completing a self-assessment form. This means the figures must be understating the true size of the spike. The OTS regard it as a distortion in behaviour and see it as an actual tax saving. However, whether that is really so or whether people are selling simply because the allowance is there is not known. My own accountant regularly draws attention to this as a possible area of tax saving to be conducted before the end of the tax year with the indication that I ought to be taking advantage of this. As a long-term holder I usually ignore these suggestions.

One further suggestion if the tax-free limit is not reduced is that it might be tapered in much the same way as the personal allowance is tapered for incomes over £100,000. They suggest that this might even start with gains as little as £20,000 with the limit reducing to nil for gains of £30,000 or more. This goes against some of the other ideas in the report and one must hope it is not one that will be pursued.

Investing in property rather than shares

It comes over clearly that people who have built up a portfolio of properties to provide for their retirement are much harder hit if they want to swap them around for some reason. Here the gain inevitably falls all within a single year and can push someone from basic rate into higher rate. At the moment it is possible for someone normally paying 20% income tax to pay 28% on part of their gain, but if the rates were aligned the 28% could go up to as much as 45% without some kind of averaging. The report also brings out the administrative difficulties of calculating the tax within the 30 days from sale of a property in which the tax must be paid unless an interest surcharge is to be incurred. It's not just finding out the original purchase price but allowing for qualifying additions for improvements etc. I am surprised there has not been more protest about this change.

The death uplift

In their reports on IHT, the OTS said that there was no justification for the uplift in the base cost where assets are transferred between spouses or civil partners with no IHT being paid. They now suggest that this should be extended to all transfers on death and the recipient would take the asset on at the original cost price. This feels like double taxation to me and could result in horrifying combined rates of tax on an executors' sale. There's a footnote to a calculation indicating that they do see that as a result the IHT payable should be related to the value after allowing for the CGT payable or potentially payable. They also suggest that capital losses might need to be offsettable against income. In passing on assets the executors would have responsibility to provide information to enable the CGT to be calculated subsequently. The report admits that there would be "difficulty" where the deceased had not kept records but suggest that rebasing to perhaps the year 2000 would alleviate this.

The main argument for removing the death uplift, as it is called, is that the present rules considerably distort behaviour by encouraging people to hang on to assets until death, whereas there would be many benefits, particularly in business matters, for earlier transfer. The fact that very little CGT is paid by over 75s may be an indication that this is happening. If the emphasis were really only on distortions of behaviour and not on raising more revenue, an alternative might be to give some credit for CGT paid in the last, say, seven years before death against the IHT. The OTS show no sign of having looked for alternatives to removing the death uplift as a way of avoiding such distortions.

Next steps

Despite the title there is not much in this first report about actual simplifications in the processes, but maybe this is to come in the second part, early in 2021. We must hope that this will address the complexities and difficulties of calculation discussed in the UKSA/ShareSoc response.

The Chancellor's original request made no mention of the possibility of additional revenue concentrating solely on simplification, making interaction with the system as smooth as possible and avoiding distortion of behaviour. This has not stopped the OTS from drawing attention to places where more tax might become payable and there are plenty of these. In the current situation it is hardly likely that the Chancellor will miss the chances this gives of getting in more money.

[1] OTS Capital Gains Tax Review: Simplifying by design - GOV.UK (www.gov.uk)

Appeal for volunteers

UKSA is buzzing with ideas and opportunities. We need volunteers of all sorts to help implement them. What we do depends on who can help. As little as an hour a week of your time would be a real contribution in any of the following areas.

Are you a techie sort of person? You could

- Learn Drupal and implement improvements to the website
- Learn CiviCrm and implement improvement to the member management system

Are you a social media junkie? You could

- Join the twitter team
- Teach us to exploit it more

Do you like writing? You could

- Turn events/papers into new items for the website
- Write or contribute to member communications
- Edit the work of the policy team

Do you like to organise things? You could

- Help to expand UKSA's provision of online events.
- Join the company visits team
- Post-Covid, help to organise conferences
- Start new UKSA regional or interest groups

Are you interested in education? You could:

- …….It's a green field! We're just starting! What do you suggest?

Call any board member or David Riches if you would like to contribute to UKSA's development

Fossil fuels: divest or engage?

Dr Quintin Rayer

DPhil, FInstP, Chartered FCSI, SIPC, Chartered Wealth Manager

Head of Research and Ethical Investing at P1 Investment Management

Biography

Quintin has worked for actuarial and investment consultancy firms and a multi-national European bank, including wide experience in quantitative fund and risk analysis. He is a Fellow of the Institute of Physics, a Chartered Fellow of the CISI and a Chartered Wealth Manager. Quintin has applied skills gained from his Oxford University Physics Doctorate and while working in engineering to finance. He is the second UK graduate from the Sustainable Investment Professional Certification (SIPC) programme and joined P1 Investment Management in January 2017, founding their ethical and sustainable investing proposition.

Introduction

Many investors are acutely aware of the risks from global warming [1], [2] including sea-level rise, storm surges, droughts, wildfires, extreme heat, and extreme weather events [3], [4], [5]. Consequently, many ethical and sustainable investors have focused on reduction in industrial carbon emissions among other measures to hasten progress to a carbon-neutral economy. Fossil divestment is one approach [6]. However, some investors argue that engagement with fossil companies is more effective in promoting essential change.

Investor motivations can include risk management or a moral position. Exposure to climate risks could undermine company valuations. On the moral question, it became clear in the 1960s that continuing CO2 emissions would progressively damage the climate. At this point, the major carbon producers could see that they were marketing harmful products. The philosopher Henry Shue [7] argued that by failing to address these harms over the subsequent half-century, fossil fuel firms have additional responsibility to correct the damage done.

This article outlines divestment and explores what engagement with fossil firms should involve. It suggests limits to the length of time spent talking with companies if there are no meaningful signs of progress.

What is Fossil Divestment?

Fossil divestment involves severing ties with firms that extract fossil fuel reserves, selling or refusing to own stock in fossil extractors and producers, and was backed by the UNFCCC in 2015 [8]. The focus may be on all fossil fuels (coal, oil, and gas), or else on only the most damaging, coal and oil from tar sands.

Estimates from 2012 suggested that to keep global warming below 2°C no more than around 565 gigatons of additional carbon dioxide could be released by mid-century. Yet proven underground coal, oil and gas reserves amount to 2,795 gigatons [6]. Far more than the climate can tolerate to remain below 2°C warming. More recent estimates indicate that at least two-thirds of known fossil fuel reserves must remain unburned [9]. The logic is simple – the vast majority of this carbon needs to stay locked and unused in fossil reserves underground.

At the 2018 IPCC meeting in South Korea, the world's scientific community re-emphasised the need to keep global warming contained. The IPCC made it clear that to avoid the worst consequences; warming must be kept below 1.5°C above pre-industrial levels [10]. Current warming is currently estimated at 1.17°C [11] and on track for 3°C or more by 2100 [12].

Why might Investors Engage?

Some investors fear that restricting investment choices may reduce diversification and impact performance, although many ethical investors disagree (see, e.g. [13], [14], [15]). However, others accept the need to reduce CO2 emissions but feel engagement with fossil extractors and producers is more likely to achieve that goal [16]. They point out that a shareholding is needed to influence a firm, so divestment removes the possibility of company engagement [17]. Critics suggest that engagement is most effective when backed up with a credible threat to divest [18]. Both groups of investors have the same goal – a low carbon or carbon-neutral future – but differ whether engagement or divestment is the more effective tool.

Robust Engagement

Given the climate risks that fossil fuels pose, engagement must be robust. It could lack teeth unless backed by a realistic likelihood of divestment if targets are not met [18]. An end is required to deliberate climate science obstructionism and continued fossil expansion.

The resulting minimum engagement criteria might include:

- Commitment to divest if minimum engagement targets are not met within defined timescales, perhaps two or five years.

- Major oil and gas companies must cease funding trade associations or activities that lobby against climate action [18]. If membership of trade associations is to continue, companies must ensure those bodies do not work to obstruct climate action.

- Executive remuneration packages and bonuses must no longer be based on fossil production volumes. Ideally, they should be based around increases in renewable energy output [18], or emissions reduction. In 2018 Royal Dutch Shell agreed to set carbon emissions intensity targets, tying them to executive pay [19]. More recent bonus schemes [20] include a 10% climate risk measure, but overall, still, reward executives for higher fossil fuel output. At BP, the remuneration scheme lacks transparency over whether it extends to include emissions from customers' use of oil and gas [20].

• Exploration for new fossil fuel reserves should be stopped with no additional capital allocated [17].

Other engagement measures are possible, but the points above would seem a good start.

The second point addresses one of the fossil companies' most perverse actions. By investing in renewable energy and headline 'green' initiatives while still financially supporting global warming deniers or other activities that obstruct climate action, firms appear deeply hypocritical and cynical.

How this helps Investors

Ethical and sustainable investors can either divest or ensure their engagement policies are as robust as possible. If using funds, they can check investment policies to ensure the approach the manager is taking accords with their personal views. The science is clear, decisive action to prevent dangerous climate change needs to be taken quickly.

Media commentary shows that many sections of the public understand this message, even if the finance sector has been slower to adjust. Clients increasingly wish to invest ethically; the Investment Association reports £40.0 billion assets in the UK responsible funds sector in September 2020, a yearly increase of £15.4 billion [21]. By addressing issues of divestment and engagement, either directly, by careful fund selection, or raising with their advisers; investors can help ensure their views are implemented as fully as possible.

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CURRENT UKSA EVENTS

Company meetings

UKSA's programme of meetings has been suspended during the current health crisis.

Meetings of UKSA Croydon & Purley Group

Location	**Spread Eagle, High Street, Croydon CRO 1QD** **Meeting dates will appear here.** **Chairman: Harry Braund** harrycb@gmail.com

UKSA BRANCHES – If no contact name or number is given, please contact UKSA office

Branch name	Leader	Administration	Main purpose	Description
London & South East Region	Harry Braund 020 8680 5872 harrycb@ gmail.com	Andrew Girvan 020 8788 1665 agirvan247@btinternet.com	To co-ordinate activities in London and the South-East	Meetings in Croydon three times a year
London company visits	Nick Steiner	Individual meeting organisers	To arrange private meetings with companies	20/30 meetings per year individually arranged
Specialist company visits	Adrian Phillips	Under review	To arrange and/or participate in events in conjunction with investor service companies	Meetings with small-company management, for experienced investors only
Croydon & Purley	Harry Braund 020 8680 5872 harrycb@gmail.com	Tony Birks 01322 669120 ahbirks@btinternet.com	Social meetings to discuss investment issues	Meetings in Croydon monthly
South West	Peter Wilson 01453 834486 07712 591032	Peter Wilson 01453 834486 07712 591032	To arrange and develop activities for members in the region	Company visits and social events as arranged
North East	Brian Peart 01388 488419	Julian Mole 07870 890973 julian.mole@ btinternet.com	To arrange and develop activities for members in the region	Company visits and social events as arranged
North West	Julian Mole 07870 890973 julian.mole@ btinternet.com	Julian Mole 07870 890973 julian.mole@ btinternet.com	To arrange and develop activities for members in the region	Company visits and social events as arranged
SmartCo	Charles Breese	Charles Breese	Arranging access to 'Smart Companies'	Programme awaiting start-up
Northern Rock Small Shareholders Action Group	Dennis Grainger nrssag@uksa.org.uk	Dennis Grainger nrssag@uksa.org.uk	Pursuing compensation for small shareholders affected by NR's collapse	Lobbying and awareness-raising activities