UK Shareholders' Association

# The Private Investor *Issue 177 · July 2015*

## Chairman's Comment

The lazy days of summer will be at their apogee when you get this, but plans are well advanced for another winter programme for UKSA.

I have been going to more UKSA company meetings, and beginning to realise how valuable they are both to the company and to shareholders and potential shareholders. These meetings are usually born out of private contacts between individual UKSA members and Company Chairmen or other senior officials (bearding the Chairman after an AGM is a good move). The London team, headed by Nick Steiner, is almost at capacity. Did you realise that if there is a company that interests you and you take the trouble to meet the Chairman and get him interested then we can cement the relationship and help you make the arrangements? And boy, can the insight that our members gain thereby be rewarding!

In this issue you will find Eric Chalker in cracking form as he marks your card for getting the most out of AGMs; and on page 10 you will have the pleasure of a step-by-step analysis by Peter Parry of what he calls 'the pretence of shareholder governance'.

To switch to other matters we are getting some professional help with our website. We are limited by money and, in my case, by time. Help in either direction would be greatly appreciated. And welcome by the way to new member Brian Hargreaves who recently sold up his brand communications company and is looking for something to keep himself interested. He has offered to help us with our branding and marketing - particularly welcome as we consider how to use our space at the **London Investor Show.**

You will find more details about the latter on page three. UKSA has a long history of attendance at the show and in addition to its specific purpose you might ponder on the fact that an active stand will be a good advertisement for UKSA and will help our wider objectives.

Good luck

***John Hunter***

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# Note it well! October 23rd!

the London INVESTOR show

The summer will be over before you know it - so put the date October 23rd in your diary now. The London Investor Show is the prime prestige annual show for investors and gives those attending the chance to hear - and to meet - leading members of the investment community - whether your interests lie in technical analysis or the world economic outlook, exchange-traded funds or pension reform, the algebraic formulae addressed to determining future movements of the dollar vis a vis the yuan, or a patient explanation of the nature and function of the price:earnings ratio.

**In the Investors Chronicle Theatre the magazine’s editor, John Hughman, a** good friend of UKSA is putting together an exclusive programme of presentations - and attendance is free.

UKSA members will have concessionary free access to The London Investor Show. In addition those who apply online will be granted additional benefits. Applications will be e-mailed to members in the next month.

One of our very own members, John Mulligan, creator of the STAR investment method is hosting a free seminar. You may recall that last year the talks of both Malcolm Howard and Eric Chalker were very well received and that a number of new members joined as a result.

Of course, UKSA will have its own stand again this year - **and that’s where you** come in. You will be especially welcome if you are from outside the region. This is a first-class chance to find another gear in your exposure to UKSA either by coming along to the stand and putting a name to some of the faces or better still - by volunteering to help man the stand. The London Investor Show lies pretty close to the heart of our ongoing promotional efforts.

***Bill Johnston***

# Making the most of AGMs – Part Two

**by Eric Chalker**

In the last issue, I began a process of examining the resolutions that shareholders are asked to approve at company AGMs. Many of these are of a standard, even routine nature, yet some of these are also 'special' resolutions, requiring a 75 per cent majority. What this means is that the directors are seeking authority for something the 2006 Companies Act won't let them do with just a simple majority. In other words, these are matters which Parliament considers to be of an especially sensitive nature.

What we see in practice is that such resolutions usually receive the same level of voting support *in the proxy votes* as do nearly all the ordinary resolutions. I have emphasised this is in the proxy votes, because it need not be so and, in my experience, may well not be so, if the chairman takes a hand vote (which, in my opinion, should always be done). If a resolution does not receive the requisite majority on a hand vote, the chairman is virtually obliged to take a 'poll', which means the proxy votes have to be counted and the vote is per share, not per shareholder. This tends to irritate chairmen, which is why some of them go straight to a poll without taking a hand vote first, claiming this to be more democratic (which, as I wrote in May, is arrant nonsense).

The special resolution which tends to receive the least support in a hand vote is that to enable the directors to buy back the company's shares. This is a subject on which UKSA's members, when a vote took place on it in 2009, were divided. The majority then, some two-thirds, thought it should be banned (as it was, incidentally, prior to 1985), but the minority supported the practice as a way – as it is thought – of using companies' cash to increase the share value and thus produce a lower-taxed, or even non-taxed, capital gain, rather than paying a bigger dividend subject to income tax. In practice, whenever I have examined the resulting share price of companies buying back their shares, I have seen that it subsequently fell, often by quite a lot.

It has been written by others that the worst investment a company can make is in its own shares. In my own opinion, an AGM resolution seeking authority to buy back a company's shares can be an indication that its directors' judgement is not to be trusted at all. This is especially so when the company

has only limited cash reserves, is dependent on its cash reserves for further development of its product, or, most egregiously, when it has net debt or an underfunded pension fund obligation. Some years ago I wrote to the chairman of an AIM-listed pharmaceutical company, not yet in profit (it still isn't), asking him in what conceivable circumstances he thought the board would act upon the authority he was seeking; he eventually wrote back to say that he had never really thought about the matter, but the board had discussed my letter and decided not to seek the authority in future.

Where does the desire to have such an authority come from? Almost invariably, I suspect, from a company's own stockbroker. Guess who gets the commission from a buy back! Of course, if challenged at an AGM, the broker's representative (he or she is always there) will disclaim any self-interest and argue that it's a tool the board should always have. I was told just that, forcefully, by a company's broker at its AGM, when £400,000 had already used for this purpose and it wanted the chance to do more; the company was in debt at the time and the debt was later called in, so the shareholders lost everything.

The interests of company brokers and their major shareholders cannot be assumed to align with the interests of private investors putting their own money into a business. They are often very different and, of course, the closeness of the broker to the board and the size of major shareholdings will usually over-ride the interests of individual shareholders. This is especially the case when the latter struggle, for one reason or another, to attend an AGM. However, when we do attend AGMs, there are things we can do, even though we know in advance the outcome of proxy voting.

In Germany, AGMs typically last many hours – even as long as ten or more – and directors are expected to ask a great many detailed questions. In the UK, chairmen will typically want the AGM over in one hour and may even time it so that few can attend (eg early in the morning) or so that a nice lunch is provided at a set time. Even so, this need not – and I would like to say should not – deter or discourage a shareholder with something pertinent to say, whether in the form of a question or not. The importance of AGMs for private investors cannot be over-stated. They provide the one chance a company's members have to question and challenge the directors over their management of the business and while many of us will find it difficult to attend these and others will be nervous about speaking up, I wish to encourage those who can to do so, in increasing numbers.

For example, when asked to give the directors authority to buy back the company's shares, stand up and ask to be told the circumstances in which the chairman thinks that might be a good idea: he won't have an answer and you might want to press him, but raising the issue might cause him to think again,

especially if you follow up the AGM with a letter to him on the subject, asking him to think again before preparing next year's AGM agenda. Even better if you have time to examine the accounts beforehand in order to check the company's cash and debt position and relate your question to figures in the accounts.

Somewhere in the directors' report you may find reference to a buy-back authority given the previous year and what was done with it. If the authority was there and not used, yet the company had plenty of cash and its share price has been comparatively low, you may want to ask why the authority wasn't used and how low the board wanted it to go before buying: there won't be an answer, but you are likely to cause acute embarrassment. Shareholders should not be asked to give directors an authority they have no clear intention of using and if they can envisage circumstances in which they think it will be in shareholders' interest to buy back shares they should be prepared to say what they are. Too often, I suspect, shares are bought back on little more than a whim; after all, it's not the directors' own money so the action appears to be painless.

Neil Collins, a respected stock market commentator of many years, writing in the Financial Times this month, drew attention to Rolls-Royce Holdings' share buy-back activity. It is a salutary story which is worth quoting. *"Last February, despite a third profit warning, Rolls launched a new £1bn share buy-back programme for no better reason than 'to reduce the issued share capital of the company.' By May 8, it had spent half the money, paying over £10 a share. Morgan Stanley had been handed this nice little earner...... A fourth profit warning saw the shares slump to 750p, there are worries about cash, and the programme has been 'discontinued'."*

UKSA members who are able to attend the next Rolls-Royce AGM might like to ask questions about this. If so, don't allow them to be answered by the new chief executive, who will simply take credit for ending the buy-back. The pertinent questions are these: *"Was the whole board involved in the decision to launch a buy-back and if not why not, what calculations were done to satisfy the decision makers that this was in the interest of the shareholders and what guarantee can the chairman give the shareholders that such an obviously stupid decision won't be made again?"*

Section 172 of the Companies Act requires each company director "*to act in the way that he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole* (including) *the likely consequences of any decision in the long term"*. Section 173 requires each director to *"exercise independent judgement."* So, following the example set by Germany, it would be entirely legitimate to ask each director

present at the next Rolls-Royce AGM whether he or she approved the decision and, if so, why?

For any company, you can check whether the previous year's authority was used by examining the annual report. Look at the cash flow statement to see whether anything other than a small amount was spent to buy shares for a staff scheme, then check the share capital note in the accounts which will tell you how many shares were bought back, divide one figure into the other to see the average price paid (but it may be stated anyway) so that you can compare this with the share price subsequently. If, as in the case of Rolls-Royce and as I have usually found elsewhere, the share price after the buy-back was significantly less than the price paid, castigate the directors for all your worth for wasting shareholders' money and weakening its equity cushion.

If you do have the opportunity of a hand vote, make sure you see how many hands are raised for and against. Chairmen often 'forget' that 75% need to be in favour for a special resolution to pass and in smaller companies the number of actual shareholders present may be surprisingly small, even in a room crowded with advisers and other hangers-on. If you can persuade 25% plus one of the shareholders present to vote against, the matter will have to go to a poll and you will have made an important point. Then send Bill Johnston a letter to tell the rest of us about it!

***Eric Chalker, Policy Director***

## A continuing tale of prudence

As members will know, our Policy Team member Roger Collinge has been doing battle for many a long year to restore the principle of 'prudence' in company accounts to its rightful place. Working with others, as previously reported, Roger amongst many others has been applying pressure to the International Accounting Standards Board (IASB) whose job it is to lay down the law on these matters for the great majority of public companies. Squirming under this pressure, the IASB has now produced a paper, written by Steve Cooper, an IASB board member, which claims that prudence never went away.

Roger has written a commentary on this, shortly to be published on the UKSA website, which challenges the IASB's thinking and sets out why it has yet to face up to what Roger – and, we suspect, all UKSA's members – regards as reality. Prudence requires judgement and that, Roger says, is inescapable if company accounts are to present a "true and fair view". Do watch for the commentary, which will appear together with Mr Cooper's paper.

***Eric Chalker, Policy Director***

# Dividend Tax

***Gerry Meredith-Smith and Roy Colbran***

How many UKSA members are hit by the new dividend tax? And how many, if any, actually benefit from the changes? The surprise new levy is an additional tax of 7.5% on dividends paid to individuals but with an annual tax-free Dividend Allowance of £5000 for all taxpayers. For higher rate taxpayers this is to be achieved by replacing the present computation by flat rate taxes on dividends of 32.5% and 38.1%. The legislation for this will form part of the 2016 Finance Act and so we shall not know all the details of its operation until next year. It is included in the list of items to be legislated "following consultation where applicable". However, since the Treasury is hoping to raise some £2 billion a year from the new tax there is unlikely to be much in the way of concessions.

One important reason given for the new levy is to reduce the incentive for traders to self-incorporate whereby they can pay corporation tax at current low and prospectively lower rates rather than income tax (and NI contributions although these do not seem to get mentioned). Another justification for the change is simplification in that the Dividend Tax Credit is an arcane and complex feature designed over 40 years ago when tax rates were much higher.

Even so we can see no good reason for loading this additional tax onto private shareholders. The excuse is given that the new rates of tax are below the main rates of income tax but this conveniently ignores the fact that the profits have already been taxed within the company, albeit at much lower rates than in the past. Indeed low rates of corporation tax should make for higher dividends.

Moreover one can see that private shareholders with what seems to be regarded as substantial wealth (i.e. more than £140,000 in shares) are a soft target. By the way, one group who actually benefit will be higher rate taxpayers with modest portfolios who will be able to receive £5000 in dividend income before paying any tax. As a result the government can be accused of hitting pensioners reliant on basic state pensions and with modest dividend income above £5,000 whilst helping some of those with higher overall incomes.

An argument made strongly by the government is that the extensive tax reliefs for ISAs and pensions are maintained. Until now basic rate taxpayers could well think that there was no strong pressure to move their shares into ISAs. Income treatment was, by and large, neutral and many would hope the annual CGT allowance would cover any realisations. By retaining direct ownership one avoided the ISA manager's charges and the cost of selling and then buying back in the ISA as well as keeping the right to attend meetings

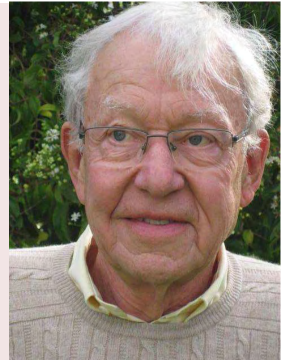
and vote. The ability to pass on ISAs to one's spouse or civil partner on death has added to the attractions of ISAs but the new tax makes it highly desirable to hold as much as possible of your shares in your ISA. Apart from using the annual allowance to the maximum from now on, one might want to consider any other means such as transferring in any cash ISAs and buying shares with the proceeds.

Apart from those who have deliberately chosen not to put too much into their ISA, there will be a number who have not had the opportunity to do so. Among those will be people who sold their business and put the proceeds into shares to fund their retirement. Also people who have lived abroad, and so not been allowed ISAs, but are retiring to the UK. These may well be hit hard by the new regime.

It would be useful for the Policy Team to know how many UKSA members are seriously affected by the new change and whether there is any strength of feeling on the matter. If you want to comment please email to policydirector@uksa.org.uk. or write to the Secretary.

***Gerry Meredith-Smith and Roy Colbran***

By the time you read this, shareholders in Alliance Trust should soon be receiving invitations to the London Investor Forum on September 29th. (We are told that registrations will open in early August.) From my past experience it is necessary to get in early to secure a place although maybe the change of venue will resolve this problem.



***Roy Colbran***

For my taste previous forums have had too much of a didactic nature and not enough about accountability. Time for questions has been short leaving most to be submitted in writing and answered on the website. As mentioned in my piece in the May edition, I have written suggesting they allow plenty of time for questions in view of all that has happened but I have not had an acknowledgment. It would be helpful if anyone registering could make the same point.

It would also be good if fellow members attending could make themselves known to one another – maybe carry a copy of Private Investor and let me know in advance at roy.colbran@zen.co.uk or 020 8654 0314

# Boardroom pay and the pretence of shareholder governance

***by Peter Parry***

In my *Examination of boardroom Pay*, published by the UK Shareholders' Association in March 2015, I looked at the general concerns surrounding directors' pay. This paper looks at a specific aspect of how directors' pay is presented in the report of the Remuneration Committee which forms part of the Annual Report. The reason that this is important for shareholders is because most FTSE100 companies provide:

***Peter Parry***

**Details of what the chief executive and other directors actually earned during the year**

**A performance criteria pay chart which shows for varying levels of performance the likely amount that individual directors will earn over the coming year**.

The governance systems on pay are supposed to function on the basis that shareholders will vote on directors' pay at that annual meeting and thus ensure effective control over the levels of pay awarded. However, as we shall see, there is a significant disconnect between what shareholders are often led to believe directors will be paid during the coming year, based on the performance criteria pay chart and what they actually end up receiving.

The analysis for this article uses information contained in the annual report for the house builder Taylor Wimpey where in 2014 Pete Redfern, the Chief Executive, earned a total of £5.8m. Taking 2013 and 2014 together he earned a total of £12.5 million. Taylor Wimpey is a good example to use because the Remuneration Report is clear and well-presented and is easy to analyse. The Company Secretary was prompt in providing answers to my queries. Taylor Wimpey is also very similar to many other FTSE 100 companies in terms of the way in which it presents information on boardroom pay.

## £12.5m over two years.....How did the CEO end up getting so much?

The Annual report for 2014 shows that Pete Redfern's remuneration over the last two years comprised the following elements:

Table 1. **Composition of Taylor Wimpey CEO's pay 2013-2014**

| **Component** | **2013** £'000 | **2014** £'000 |
|---|---|---|
| Fees and salary | £749 | £768 |
| Benefits | £30 | £43 |
| Short term incentive award | £1,018 | £1,043 |
| Long term incentive plan | £4,747 | £3,770 |
| Pension | £180 | £185 |
| **TOTAL** | **£6,724** | **£5,809** |

It is interesting to note that 'fees and salary' (basic salary) makes up just 12 – 15% of total pay while around 60% of the whole package in each year is accounted for by long term incentives (LTIPs). As with so many other FTSE companies, these LTIP awards typically take the form of share options and 'performance shares'.

In many respects Taylor Wimpey's Remuneration Report is good, in that it gives plenty of detail about directors' pay and its composition. It also gives plenty of information about the performance criteria that directors have to meet to achieve their bonus targets. One may disapprove of the levels of pay but the remuneration report scores well on information disclosure. But just how helpful is some of this information for shareholders who are supposed to control directors' pay by monitoring and voting on proposed pay awards?

## Lies, damned lies and statutory requirements!

The 2014 Annual Report gives a Performance Criteria Pay Chart showing the pay that Pete Redfern and two other directors can earn over the coming year (ie this year, 2015) depending on their performance. For Pete Redfern the Pay Chart shows the following information:

Table 2. **Performance Criteria Pay Chart 2015**

| | **Below target** | **Target** | **Maximum** |
|---|---|---|---|
| % of remuneration accounted for by: | | | |
| LTIP | | 16% | 42% |
| Bonus | | 31% | 31% |
| Salary | 100% | 53% | 27% |
| **Total Remuneration £'000** | **£1,030** | **£1,946** | **£3,816** |

From this shareholders might think that the maximum amount that Pete Redfern can earn in 2015 is £3.8m. This is significantly less than the £5.8m that he earned in 2014. So does this mean that the Company is starting to get the CEO's pay under control? The answer to this is, no! If we look at the Performance Criteria Pay Chart in the previous year's (i.e. 2013) Annual Report we can see that this is far from being the case.

Table 3. **Performance Criteria Pay Chart 2014**

| | Below target | Target | Maximum |
|---|---|---|---|
| % of remuneration accounted for by: | | | |
| LTIP | | 16% | 42% |
| Bonus | | 31% | 31% |
| Salary | 100% | 53% | 27% |
| **Total Remuneration £'000** | **£962** | **£1,829** | **£3,601** |

This suggested that Pete Redfern might earn a maximum of £3.6m in 2014. In fact, we know that he earned £5.8m. If we look back to the 2012 Annual report a similar picture emerges. The Performance Criteria Pay Chart suggests that Pete Redfern might reasonably have expected to earn about £1.7m for 'Target' performance and that the maximum he could possibly have earned given spectacular performance would be £3.5m. But, as we know, he was paid £6.7m in 2013 - almost double what we might have expected from the information given in the 2012 Annual Report.

So has Pete Redfern's remuneration always been significantly higher than shareholders might have expected? The 2012 Annual report shows his total pay took a sudden leap in 2013 as the table below shows.

Table 4. **Taylor Wimpey CEO Total Remuneration 2011 -2014**

| | 2014 | 2013 | 2012 | 2011 |
|---|---|---|---|---|
| Total remuneration £m | £5.809 | £6.724 | £1.837 | £1.771 |

Thus, it was only from 2013 that fairly aggressive share option and 'performance share plans' put in place in 2008 (and approved by the shareholders at the time) started paying out. Superficially, the logic of this sounds simple, but let's just take a closer look at how it all works.

## Effective governance and statutory requirements for reporting on pay… Who designed this?

In March 2015, I wrote to Taylor Wimpey and the Company Secretary promptly responded with the following fulsome explanation:

*The pay scenario chart, looking forward to the year in question, and the pay table published the following year, looking back at the year in question, have different constituents.*

*The former shows what an Executive Director's LTIP reward would be, if maximum vesting was achieved, when that LTIP vests. That is three years' hence, at the end of the LTIP performance period, and not the following year. The following year, we report pay, benefits, pension and STIA (bonus) all as per the pay scenario chart forecast published the preceding year, but the one remaining element of that year's cash receipts – LTIP vesting – relates to an LTIP awarded three years earlier, whose three year performance period has just ended.*

*Thus there is a disconnect between the elements in the 2014 pay scenarios as forecast in the 2013 Annual Report, and the element included in the reporting of the cash actually received from the Company during 2014 as reported in the 2014 Annual Report. The LTIP in the former (the pay scenarios chart for 2014 in the 2013 Annual Report) is the 2014 LTIP award that may vest in 2017 and be reported in the cash earnings for 2017; whilst the LTIP in the latter (the pay table for 2014 in the 2014 Annual Report) includes the value of the LTIP awards from 2011 (part) and 2012 (part) that vested during 2014, as described on page 79.*

*During the three year performance period of the awards made in 2010 and 2011 but vesting and paid out in 2014, the shares awarded increased in value on the Stock Exchange by 192% (2011 LTIP award shares) and 161% (2012 award).*

*In reporting terms, the methodology to be used for each of the scenario chart for a year and the single figure reported for the same year, are prescribed by statute, and thus give rise to the apparent inconsistency you have identified.*

**Did you understand all that? No….? Well, I'm not sure that I do either. I sort** of get the gist of it but the complexity of the whole arrangement means that **it is nigh on impossible to understand what Pete Redfern's total remuneration** is going to be in any given year – even if we assume for the sake of simplicity that he will achieve or exceed his most stretching performance targets for the coming year. I suspect that even he may not fully understand it.

One other point to note is the comment by the company secretary that Taylor Wimpey is following a reporting methodology which is prescribed by statute. In other words, if the information is presented in a way that is misleading (and which also strikes at the heart of effective governance), it is **not the Company's fault. This is a matter of concern to the UK Shareholders'** Association, which was taken up unsuccessfully with the previous Secretary of State for Business (Vince Cable) and is likely to be raised again with his successor (Sajid Javid).

## Conclusions

Two good reasons for analysing the Taylor Wimpey remuneration report are:

- The obvious discrepancy between what shareholders are being led to believe Pete Redfern can earn and what he has actually earned over the last two years.
- The relative clarity of much of the information presented.

**Other companies use a similar system of publishing an 'estimate of future potential reward opportunities' for executive directors along with a single total** figure of (actual) remuneration. In the case of Babcock International Group, for example, these two figures look to be more closely aligned. In 20014/15 Peter Rodgers, the CEO, earned £4.16m compared to a maximum projected of **– yes, you've guessed** - £4.16m. Bill Tame, the CFO earned £2.078m compared to a maximum of £2.438. Bear in mind that these estimates of the maximum payments are just that – estimates of the absolute maximum that they could earn given a spectacular performance. The estimated pay for on-budget performance for Peter Rogers and Bill Tame would have been £1.571m and £958,000 respectively. Clearly, there are serious questions that **need to be asked about the setting of performance targets if the 'stretch'** targets are consistently being achieved or exceeded. In the case of Taylor Wimpey the base-level, on-budget and stretch targets are fairly clearly set out. In the case of Babcock there is, in my opinion, much less clarity.

The full review that I have done of Taylor Wimpey's remuneration report can be accessed on the 'Current Papers' tab of the UKSA website. In the meantime, it is clear that the system of governance which is supposed to allow shareholders to monitor and control director's pay is fundamentally flawed. Even in the case of Taylor Wimpey (whose approach to remuneration reporting scores well on comprehensiveness of information and clarity of layout) statutory compliance seems to allow and even require the publication of information that is patently misleading. In other cases in which companies are publishing less information – particularly on the performance targets against which bonus payments have been made – it is almost impossible to tell what is going on and whether handsome pay awards made to directors are anything like justified.

**Peter Parry**

## Appeal

We have been contacted by Gerardo Baena. a lawyer at Cremades Calvo Sotelo Law Firm and legal adviser of AEMEC (Spanish Association of minority shareholders of Listed Companies) in respect of a study on **Financial Malpractice** the law firm is currently conducting.

In the light of what happened to a Spanish company REPSOL that was negatively affected by the financial instability of its majority shareholder (SACYR), Mr. Baena has decided to undertake a comparative study on European listed companies that have also been adversely affected because of their majority shareholder. In other words he would like to know if there are other cases in which the financial instability of the majority shareholder of a listed company has affected the rest of the company, its shareholders, the value of shares etc….

If any member knows of any listed companies that have recently faced or are already facing problems as a result of the instability of their majority shareholder it would be of a great assistance.

If this elicits any interest, the e-mail address to contact is: gbaena@cremadescalvosotelo.com

# The Smartest Guys in the Room - Postscript

In the last issue, I wrote a few remarks about Enron and mark-to-market accounting. A bit of further reading took to the UK connection here with the 'Natwest Three' whose involvement with Enron led three NatWest employees to jail sentences in the United States. Obviously I do not want to comment on this—but in an exculpatory book by one of the men (*A Price to Pay: The Inside Story of the NatWest Three* by David Bermingham) give an amazing insight into '*Investment Banking'* when applied to a UK Clearing bank.

As the story is told NatWest, which had bought an American boutique, (***Greenwich)*** retired the then Chief Executive of NatWest Markets and persuaded the Greenwich Joint Chief Executive to come to London and run a reconstituted organisation. The man in question, Mr. Kruger, a brilliant but ruthless individual we are told changed the name to Greenwich Natwest. Moreover he found the Structured Trade Finance Department being run by some employee or other guilty of 'old bank' thinking and turfed him smartly out and replaced him by one Gary Mulgrew, later one of the co-indicted colleagues of Mr. Bermingham and one whose new-bank thinking eventually propelled him into an American prison.

What was Structured Trade Finance? Well it can mean many things to many people we are coyly told, but the resources of the department were mainly used for off-balance sheet financial transactions. What is off- balance sheet finance? Well the example we are given is that of a sale-and-leaseback which 'in one way' can be regarded as 'assets and liabilities that don't appear in the balance sheet'. Humph. This does not seem a very good example. If you sell an asset it's not yours, is it? True, you may have a contractual liability of a long lease, but costs, even fixed costs, are not the same as debt are they? Are there any better examples?

Well, some of the brief description of the job which follows is good orthodox stuff even if much of it could relate to ordinary lending ,or at most project-finance rather than what the writer calls off-balance sheet transactions. It is perhaps a weakness of the book that the sole such operation described in detail - the one which led to the prison sentences – quite apart from the defalcations alleged or acknowledged, was itself consciously designed to allow Enron to report 'earnings' which were not earnings at all, not then, not later, not ever, not by any definition known to mortal man, a judgement later confirmed *inter alia* by the wiping off the map of the company's once great international audit house, Arthur Andersen.

Mr. Bermingham points with pride to the transaction which preceded his downfall an (Enron-related) $2 billion loan which helped the Texan company acquire Wessex Water; the loan was underwritten and syndicated so that 'not a single dollar of it remained on the Greenwich NatWest (NatWest?) book'. Now if we are being churlish a loan, even a large loan, properly structured and secured on a United Kingdom utilities company does not, of itself, seem the sort of thing that you would stop people on the street to draw attention to. On the other hand, it was classic investment-banking work, ***asset-lite*** the loan created and passed on, generating a healthy fee in the process. But you have to ask.

Mr. Kruger hated equities. A sound view, honestly presented no doubt. He hated to hold assets too, all too conscious of their potential to turn sour in his hands. But here's the thing. I always understood merchant banking involved the bringing into being of equities or long-term quoted loan stock, assets to be channelled into broadly-based portfolios held by investors either as individuals or collectively, in pursuance of the objectives normally regarded as being held in common by long-term savers for both private and public beneficial ends; assets that is whose investment characteristics are at odds with the qualities normally regarded as desirable in bank balance sheets. But are ordinary loans not the very stuff of those sound bank balance sheets especially if their average duration can be extended by the judicial use of wholesale markets? But here we have a high-profile subsidiary of a major world bank anxious to offload these loans as dangerous things to hold – and be well rewarded for doing so. Rum.

So in pursuance of fees Mr. Kruger shrank the loan book he had inherited as key to the immediate generation of bank earnings – millions upon millions of dollars we're told. But NatWest was surely a sitting duck. Kruger set about the liquidation of his legacy loan book 'minimising the capital tied up, and maximising the fees earned'. Moreover, we are told that if the loan to be disposed of had a credit reserve against it (having been previously established by deducting pre-determined amounts from the income produced by it for example) this total was gleefully knocked off the face value of the loan, and then, even if the loan could only be sold for less than its face value, provided that the sum realised was greater than the face value ***less*** the credit reserve, there was a profit – and a bonus prospect. Rich.

The indications now is that the last (UK) man standing, Barclays, is now downsizing its investment banking operations. Bad luck on the investment bankers maybe, put perhaps not so bad for bank shareholders.

***Bill Johnston***

# Commissioner Hill

In his speech at the Better Finance CMU conference, Commissioner Hill - responsible for Financial Stability, Financial Services and the Capital Markets Union – personally stressed that "*the Capital Markets Union will not work unless it works for individual savers and investors*".

In order to make it work for them, policy makers should start by getting rid of the high barriers to individual shareholder engagement in the real European economy. Sadly however, and despite the efforts of Better Finance, the current parliamentary discussion on the revised Shareholders Rights Directive (SRD) seems to blatantly ignore this CMU priority, as pointed out at the conference by the vice chair of the European Parliament's ECON Committee Markus Ferber: "*I am concerned that the Shareholders Rights Directive is turning into the "Intermediaries Rights Directive*".

Besides restoring easy access to equity markets for individual investors in Europe, the Capital Markets Union will need to look at improving long term net returns of intermediated – 'packaged' – investment products as a matter of urgency. As it stands, dismal returns are largely to blame on the high – and often not properly disclosed - fees charged by intermediaries who stand between the individual investor and the companies. According to Sven Giegold, the Green MEP spokesman, "*when you have, say, a fund investing in shares, and you demand from a consumer 1,5% in fees per year [...], then this is simply a form of organised robbery.*"

After all is said and done, without trust in the financial system, capital markets will simply fail to attract individual savers and investors back. "*How do we rebuild trust?*" asks David Wright, Chair of IOSCO, the worldwide organisation of financial supervisors. His answer "*won't please everybody: for those who miss-sell products deliberately, it should be jail. Jail! I'm tired of listening to people whose lives have been ruined by deliberate miss-selling of products*."

Great stuff! ***Bill Johnston***

It's a long time since we heard anything about the French being miffed about English rather than their own tongue as the official language of the EU. Perhaps they should ponder on the fact that it has been decided to change the name from 'the European Federation of Investors and Financial Services Users' to 'Better Finance', or in French *'Fédération Européenne des Épargnants et Usagers des Services Financiers'*. Apart from anything else, look at the time it saves.

# Do your company's directors know what 'strategy' means?

**by Eric Chalker**

It is evident to me that some company directors haven't a clue about strategy. This revelation is a consequence of new Companies Act Regulations which came into force in October 2013 and are now applicable to all company annual reports except those covered by the 'small companies exemption' and, in part, to what are defined as 'medium-sized'. These are currently companies with less than 50/250 employees respectively, turnover of no more than £6.5m/£25m and balance sheet totals half those figures.

The Regulations are delightfully short, just three clear pages. The Financial Reporting Council (FRC), however, has seen fit to publish 30 pages of "Guidance" plus four appendices. Whether company directors really need quite such a hefty book to read before spelling out a company's strategy is, I feel, somewhat open to question, but there can be no doubting the importance of this change in reporting requirements. However, the Guidance is welcome inasmuch as it makes fewer distinctions between types of company and sets 'best practice' for all.

The Regulations tell us that, *"The purpose of the strategic report is to inform members of the company and help them assess how the directors have performed their duty... to promote the success of the company."* That requires *"a fair review of the company's business and a description of the principal risks and uncertainties facing the company."* There is a fair amount of detail to support these fairly unexceptional requirements, but for me the real innovation is this: *"In the case of a quoted company the strategic report must include a description of the company's strategy (and of) its business model".*

My understanding is that AIM companies are not regarded as "quoted" for Companies Act purposes, but that is not a good enough reason for their directors to ignore the FRC Guidance, especially when it comes to telling their investors what their goals are and how they plan to achieve to achieve them – ie their strategy. This is where lack of understanding may become apparent. When I read a strategic report, I hope to discover what the strategy is and, if I don't, I tend to ask the chairman to explain. Similarly, when I don't understand from the report what the company's business model is, I will say so and in one such instance (Mi-Pay) I am still waiting after more than two months, so I guess the chairman himself doesn't know.

This is a subject which merits further study, so do send Bill Johnston your letters if you come across anything deserving of comment.

# Letters to the Editor

***Dear Sir,***

Having read the recent letters by Charles Breese and Malcolm Howard which were of great interest, I considered more closely the brief aspect of employment offered to the young, either directly without higher education qualification, or, to those who have graduated from universities. For both of these categories of employment there are essential elements, on one hand the desire by some to be moulded into a skill and make a valuable contribution, or, as desired by others, to contribute by utilisation of an education to demonstrate the alternative path of personal development.

However, the letters convey the current inherent problem which exists within most companies, the means of recruitment and its adequacy. In both cases, unless I have misinterpreted, it should be possible to gain employment by any good recruitment system which gives an equality to the job applicant. However, what is noted is the success achieved by Mr. Breese for his son and alternatively, what appears the concern Mr. Howard expresses in respect of graduates and particularly how they are selected. In all of this, whilst some companies are giving a thought to a practical approach for certain jobs and this is welcomed, maybe others are being too selective and the possibility exists that the recruitment system for both elements and specifically some graduates, is not because of a low standard in all cases but the methods being used for recruitment.

In this I have a particular issue, as someone in the 1970's who recruited mainly new staff to start up the initial operations of a major successful oil field in the North Sea after the platforms were installed, I have the belief the online recruitment system now used is presenting a serious problem. This is because the system as used by major industries becomes useless if a company wants to seriously and quickly develop an output. Specifically, the programmes which exist and are time consuming and generally speaking often reject potentially good people because they are not able to satisfy the inherent "tick box" method incorporated as a part of the system.

The underlying "tick box" system is, I believe, derived from a survey or poll method of analysis which has been developed for computers and enables the creation of an anomaly for ease of rejection. As such, the computer is unable to understand in the case of recruitment, the human factor relating to the job being created. Hence, we have a situation which discriminates if the conditions of the "tick box" are not met, as against easily granting an

interview in which the candidate may have been able present themselves in a way which demonstrates they could achieve meeting the job requirement.

It follows, if you reject applicants too easily, this has a major effect on a developing company who may require both practical and academic input from staff for the long term. Also, it may exhibit itself by the constant complaint of being unable to obtain adequate staff to meet the needs. In turn, there is an added adverse effect for shareholders who have put at risk their finances in the company investment and do not get the rewards expected because of a misplaced recruitment system.

To prove if this is correct, why not ask any major company director to apply for a job by the online system and answer the questions truthfully. With this, aim for checking if the underlying "tick box" can ensure they satisfy the job specification correctly. Also, in the final instance, ask them whether, or not, they became directors by applying via an online system, or, if they were asked by other means to fill the post.

This now brings me back to my young son, who has received little help or interest from major companies in the engineering field, although he has applied to many companies and has a MEng. Electrical and Electronic Engineering and a PhD. Engineering Science, plus, has the practical skills directed by myself. I having been an HM Royal Dockyard time served engine and machine fitter, with a degree in engineering from a so-called top UK University. The outcome as indicated, has been an online system which has proved an obstacle in all respects for this son, whereby the "tick box" condition is not met and no invitation interview has taken place.

However, I have another son, somewhat older, with a degree in accounting and economics, who has never filled in online system application and now by invitation, is a CEO of a very sound and respected large private holding engineering company with wide ranging expertise and a very large workforce.

It follows, when a company in which an investment has been made, bleats it cannot obtain the right people, check out with them their methods of recruitment and question why they have a problem in obtaining upskilled personnel. After all, it may be your investment money and time they are wasting is caused by the wretched modern online recruitment system now being used by British and inward investment companies.

***R. D. V. Kite***

***Dear Sir,***

Sometime ago we were asked to send our thoughts on bonuses. I did nothing at a time but in the article there was a phrase "we can hardly abolish bonuses" and this has stuck in my mind ever since.

Why not? The fact is that we have been softened up over the years (the 1960' ?) to the effect that the higher echelons are entitled to those badges of success that should be reserved for entrepreneurs. The latter at least have rationale behind them. The former? Quite apart from the seeming impossibility of ranking them in respect of effort, the gentlemen in question are already highly paid. Anything further is just theft from shareholders.

It has been calculated that today, bonuses, options & etc. comprise a figure equivalent TO 95% of dividends. 75 years ago it was less than 10%.

We are supposed to agree that this is just! Do you think a robber whose spoils are seized should be compensated. And who do you think (to take but one example) directors of Investment Trusts are kidding when they seek performance fees? It shall make me want to join the Scottish Socialist Party.

***David Thornber***

# Chesnara plc

This extremely interesting business whose main activity is the management of closed life and pension books ('running off') has agreed to give a presentation to UKSA members in London on Tuesday the 8th September.

The meeting will take place at the offices of the company's broker, Panmure Gordon, at One New Change, London, EC4M 9AF. Those attending will meet at 10:45 and the number will be limited to 25 people. David Lowe is our organizer, and those wishing to attend should apply through the UKSA website http://www.uksa.org.uk/members-area/events/future-events or to djmlowe@btinternet.com (tel.: 020 8398 4058; mobile: 07751 127 586)

Chesnara has a subsidiary in Sweden which is open to new business and has recently entered the Dutch market. To what extent does this change of trading profile mean a change in philosophy? Are further purchases of closed life companies on the cards? To what degree can analysts make any reasonable assumption about future earnings if the latter is in prospect? These and many more (more intelligent no doubt) questions can be put directly to John Deane the Chief Executive. A typical UKSA opportunity.

***Bill Johnston***

# 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

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 ,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

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

## 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.

# Roger Jackson ACIS

Some years ago I attended the AGM of a major public company along with Roger Jackson when he drew the attention of the Chairman to an error in the Annual Report & Statement of Accounts. It was a typical intervention by Roger, forthright and accurate, and accepted as such by an authority on company law.

UKSA benefited from his knowledge of company law when, in its formative years he attended many meetings in London during the setting up of the organization. Also, at a local level in the North East Region, along with his wife, Hilda, he was most supportive in actively participating in the many discussion group meetings. Meetings with Roger present were never dull.

Roger was born near Harrogate in 1927, and attended Knaresborough Grammar School, leaving at 15 to work as a clerk for the Harrogate Gas Company. He returned there after completing National Service, serving in Penang, Malaysia, Following years of study at night school in Bradford, Roger qualified as a Company Secretary, and took a keen interest in the work of the Association of Company Secretaries. During his career in the gas industry he undertook various managerial roles and at the time of his retirement was Contracts Manager for North Eastern Gas.

Illness in recent years prevented him from attending UKSA meetings, but he continued to take an interest in private investment. He invested with an emphasis on being an owner of part of a company rather than being a 'short term trader'. Roger died at home in Leeds on the 10th May this year.

***John Hillman***