

Achieving better corporate accountability

By Eric Chalker

On the weekend of December 12/13 2015, a letter appeared in the Financial Times from Lord Hodgson, a Conservative peer with more than 40 years' experience in the private equity, securities and investment banking industries. He has an interest in City regulation structure and was a director of the Securities and Future Authority which preceded the Financial Services Authority.



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Lord Hodgson expressed concern at what he perceives to be moves towards "a litigation culture" reflective of the trend in the USA, where "every drop in a share price can lead to class actions". UKSA's directors share Lord Hodgson's antipathy to such shareholder actions, which is why UKSA no longer initiates them, but we do not share Lord Hodgson's alternative, which is to put our trust in regulators to prevent, or remedy, financial damage suffered by shareholders from wrongdoing. Regulators are necessary, but cannot be relied upon.

What matters to us, more than anything else, is investors' ability to call company directors to account. That means *all* investors who have put money into a company's shares, including those using pooled nominee accounts, which are now reckoned to be at least half of all private equity holdings. The trend for years, facilitated and even encouraged by the regulators Lord Hodgson applauds, has been to make it increasingly difficult for private investors to exercise the rights of ownership. We have even seen blatant interference with such rights as do exist, where the regulators have declined to intervene. Parliament, too, shows little if any regard for the vulnerabilities of private investors in the face of arbitrary or predatory action against their interests.

My letter to the FT in response to Lord Hodgson's wasn't published, so I have now written to him, to explain our position. This is some of what I have told him.

UKSA has regular contact with the **Financial Reporting Council**, but its chairman, Sir Win Bischoff, admitted last year that he had been unaware that

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investors in nominee accounts are not regarded as shareholders by English courts (ie they have none of the shareholder rights provided by the Companies Act).

For nearly a year, our representatives (John Hunter and me) were active members of a **Financial Conduct Authority** committee appointed to examine shareholder rights and protections for investors in pooled nominee accounts. Despite us providing a wealth of information and evidence to show how disadvantaged these investors are, the committee – which in effect means the FCA itself – was unable even to make recommendations for reform. We learned during the process that a similar enquiry had been initiated 14 years before by the **Bank of England**, but that also came to nothing.

The FCA even dismissed our concerns about custodian risks faced by investors in pooled nominee accounts (including SIPPS and ISAs), sheltering behind its regulations (which it apparently assumes will always be respected) and unconcerned by the fact that recovery of shares in the event of custodian failure (which does happen) may take months and compensation for any residual loss is limited by the **Financial Services Compensation Scheme** (established by Parliament) to a derisory £50,000.

We have corresponded and spoken with the **Takeover Panel**, whose “*central objective is to ensure fairness for all*”, yet it shows no interest whatever in the fact that investors in nominee accounts (other than the small number enjoying Part 9 information rights) are not entitled even to be notified of a proposed acquisition by scheme of arrangement, let alone vote on it.

The primary need, I have told Lord Hodgson, is to act upon the Kay Review’s 17th recommendation and provide every private investor with the means of holding shares electronically, with own name on the share register and full entitlement to receive company reports, attend meetings and vote. I mentioned that, prior to the last general election, a significant amount of work was done within BIS to prepare for this, but with the change of government the momentum has been lost. In the mean time, I added, the scope for legal ownership of company shares by individuals is diminishing and, quite possibly, will eventually disappear.

Although we share Lord Hodgson’s disapproval of class actions, because, if successful, they “*simply shift value to some shareholders at the expense of others*” while enriching lawyers, we cannot be blind to the fact that private investors have benefited from such actions in the Netherlands and Australia, not just in the USA. If class actions are to be kept at bay in the UK, this will not be done by relying upon regulators, because they cannot be trusted to act in the interests of those who put their own money at risk – as both the FCA

and FRC have recently demonstrated by failing to pursue those who presided over the banking crisis, but in other ways too. Increasing the regulatory requirements doesn't help either, because that simply drives up costs from which, ultimately, through stock broker charges and restrictions, private investors tend to suffer the most.

There are many ways in which private investors could be given more powers. Above all, they must be given all the rights of ownership. Doing this won't stop all financial wrongdoing, but it is fundamental to a better future.

Increasing the value of company reports

Turning to another important matter, the role of the Financial Reporting Council, a government agency, is of course to promote good corporate governance. One element of this is constant attention to the way in which companies report to their members, the shareholders, in their annual reports. As we approach the principal company reporting season, UKSA members may like to see the end of year advice published by the FRC for preparers of company accounts, which can be found in two PDFs:

<https://www.frc.org.uk/Our-Work/Publications/FRC-Board/Year-end-advice-to-preparers-larger-listed-compa.pdf> and <https://www.frc.org.uk/Our-Work/Publications/FRC-Board/FRC-Letter-Year-end-advice-to-preparers-smaller.pdf>

The FRC has also published its advice for clear and concise narrative reporting, in a PDF which can be found here: <https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Clear-Concise-Developments-in-Narrative-Reporti.pdf>

All company chairmen should be aware of the FRC's guidance, so if you don't think an annual report sufficiently reflect this, do ask why not. Some company chairmen like to keep questions to a minimum, but an annual general meeting is a meeting of *members* – ie the shareholders, the owners of the business to whom it is the duty of the directors (who may not even be members) to report. I encourage all UKSA's members to participate fully in company AGMs they attend.

I am still looking for someone with an interest in helping to define what should be included in the strategic report element of annual reports, so please do step forward if this is of interest to you.

News items to be found at www.uksa.org.uk

Although it is sometimes a slow process, it is worth checking the UKSA website periodically, because items of interest to private investors can be found there, even while the site is being developed.

Members for whom we have an email address were recently notified of two items:

- The first two assessments of AIM company reports, produced by Mark Gahagan and Hubert Beaumont. One, about ASOS, produced an immediate reaction from the company, so we do have visibility! More are on their way, which I expect to be on the site by the second half of February.
- Our consultation response to the International Accounting Standards Board (IASB – responsible for IFRS) following publication of its 'exposure draft' for a new 'conceptual framework' for IFRS. Roger Collinge has worked hard on this and come to the conclusion, which I have endorsed, that further and better thinking is required by the IASB before investors can have the confidence in IFRS to which they are entitled.

Two other news items have since appeared: a newsletter from the IASB and a report from our newly appointed representative to Better Finance, Helen Gibbons, on action being taken by investors in response to the VW scandal.

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