POLICIES FOR A SHARE-OWNING SOCIETY

U K Shareholders Association

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Chairman: Dennis Cockerill, 3 Cannongate Avenue, Hythe, Kent, CT21 5PS   Tel. 01303 262809
Secretary: Keith Clegg, 17 The Poplars, St.Albans, Herts, AL1 1UW   Tel. 01727 766546
Information Line: 0171 244 9777

SUMMARY

1. Over the last decade, Britain has moved towards a share-owning society, through privatisations and demutualisations as well as through the growth of savings schemes such as pensions, endowments and PEPs. But there is still no single government body to promote savings and investments and to protect the interests of savers and investors, and the consumer has little say in the development of government policy, or in the regulation of the investment industry. As a result, there has been no consistent strategy for developing savings and investments in this country, while the ever growing numbers of investment consumers have seen their interests coming a poor second to the interests of the investment industry. These policies seek to redress the balance, and to address some of the difficulties faced by private shareholders in particular.

2. The interests of private investors should in future be fully represented, as a matter of course, on bodies considering corporate governance and other investment matters.

3. Government policy on investment affairs should be developed and managed through a single powerful body - a savings and investment authority. It must be answerable directly to government and accountable to parliament, and not to industry practitioners. It must recognise that there is frequently a conflict between the interests of investment consumers and of the investment industry, and must put the consumer first. It should monitor regulatory processes and recommend reforms where necessary.

4. The Stock Exchange combines the roles of private club, effective monopoly and regulator; where this creates conflicts of interest, it has consistently placed the interests of its members above those of private investors. These conflicts must be resolved, and alternative exchanges encouraged.

5. Financial literacy should become a part of the educational curriculum, at every level.

6. Anti-competitive practices in the financial services industry, such as excessive exit fees and hidden charges, should be identified and abolished.

7. The complex and expensive patchwork of savings schemes - PEPs, VCPs, SCPs, TESSAs &c. - should be rationalised for maximum flexibility and minimum cost, to encourage savings and investment.

8. The tax system should cease to discriminate against direct investment in shares - and so should the Stock Exchange.

9. Most UK shares are owned by collective funds on behalf of private citizens. Fund managers should be made more accountable to their investors, through disclosure of their votes in companies where they hold significant stakes.

10.The pressures to move into nominee accounts have disenfranchised a large and growing number of private shareholders: our ownership rights - such as voting, attending company meetings and receiving company information - must be restored.

11.Company announcements should be treated as public information to which all shareholders are entitled. The emphasis should be far more on disclosure to shareholders as a whole rather than to privileged groups such as institutions and analysts. Annual/interim reports and other announcements should be published, where possible, outside trading hours, and should at the very least be made available immediately, free of change, on the Internet so that all shareholders have the same opportunity to respond to the information as professional and institutional investors.

12.Annual and other General Meetings should be reformed to ensure that all company directors are subject to periodic election, that controversial issues cannot be buried in ‘composite motions’ and that shareholders are able to vote on any increases in total board remuneration.

13.The election of directors is currently a polite fiction. Boards of directors need to be more responsive to shareholder concerns, and non-executive directors need to be more independent. The election process should be reformed to encourage alternative candidates, and to allow shareholders to judge the credibility of candidates.

14.Take-overs are an essential investor protection against ineffective or self-serving managers, and should not be subject to a ‘public interest’ test except where consumer or national interests are at risk. The members of newly-converted life-assurance companies are especially in need of this protection: the 5-year rules protecting these companies from take-over should be abolished.

15.Annual accounts can be a haven for dubious and creative accounting practices, because external auditors are effectively answerable to company directors rather than shareholders. Auditors should be legally liable to shareholders, and should be banned from providing both the statutory audit and unrelated services for the same company.

16.Rights issues are a fundamental protection of a company’s existing investors; pre-emptive rights must not be diluted or abandoned.

17.Regulation of utilities should be fair to shareholders and customers: it should provide for a fair return on investment, within a known and stable regulatory environment, and should reward the most effectively managed companies. Competition should be encouraged to enter the market.

18.‘Junior stockmarkets’ for small businesses need private investors to provide liquidity for the companies’ shares. Private investors should be given proper access to these markets, to enable these markets and the companies that list on them to prosper in the long term.

1. THE GROWTH OF SAVINGS IN BRITAIN

1. Over the last decade, the amount invested on behalf of the average British citizen has soared; this trend is set to continue, as we are increasingly required to provide for our own futures. The number of citizens who are heavily dependent upon savings tied up in company pensions, personal pensions, endowments or PEPs has grown dramatically; these savings, in turn, are largely invested in shares. The success of those investments, and the degree to which they are safeguarded, will determine how comfortable we are in our old age. The increasing number of citizens building their own retirement funds will reduce the future pensions burden on government. And British industry too can invest for its own future, using this constant flow of savings.

2. So savings and investments are already enormously important, to the government, to British industry and to most citizens. Most citizens may not yet think of themselves as investors, but they are already participants in a share-owning society.

3. And yet this has developed in a haphazard way, with little co-ordination. There is still no single government body that exists to promote savings and investment, and to protect the interests of investors. Responsibility for various aspects lie with the DTI, the OFT, the Treasury and a host of quangos or self-regulated bodies. Self-regulatory bodies can work, but all too often they put the interests of practitioners ahead of the interests of consumers. In the savings industry, the practitioners are driven largely by commission, and the result has been a series of mis-selling scandals. The mis-selling continues - even now, 25% of pension schemes are abandoned within two years, on the most recent PIA figures - and the overwhelming majority of victims of the personal pension scandal still await compensation.

2. RECOGNISING THE VOICE OF THE PRIVATE INVESTOR

1. Private shareholders and consumers of investment products seem to have no place in the regulation of the financial industry. For example, private shareholders were not represented on the Greenbury Committee or the Cadbury Committee, and are not represented on the Hampel Committee - or on standing bodies such as the Accounting Standards Board, or the Securities & Futures Authority.

2. Representatives of savers and investors, and broader consumer groups such as the Consumers' Association, should be able to play an active part in determining the policies that affect us. A new department of savings and investment, on the lines of the old Department of Consumer Affairs, could also help to receive and represent savers' views.

3. THE NEED FOR A SAVINGS AND INVESTMENT AUTHORITY

1. We need a powerful body with a clear brief to consider all aspects of private investment (including insurance funds, collective funds and direct shareholdings), to make recommendations to government for legislative and regulatory change and to promote public awareness of investment issues. It must be responsible to parliament and answerable directly to the government - not to industry practitioners. It must recognise that there is frequently a conflict between the interests of investors and the interests of industry practitioners, and must make the interests of investors its primary concern. It must be focused, consistent and professional. It should recruit senior personnel who are experienced in the investment and business world but who do not have divided loyalties: poachers can make excellent gamekeepers, but not if poaching remains their primary source of income. It should invite comment, consulting broadly and publishing its conclusions. It should be aware that the costs of regulation are ultimately born by the saver, that effective regulation need not be expensive, that expensive regulation may not be effective and that cumbersome regulation may actually obscure industry abuses. It need not itself act as a regulatory body, but should monitor regulatory processes and recommend reforms where necessary. It should, in particular, monitor the effectiveness of existing self-regulatory bodies, and should recommend alternatives where the SRBs are failing to protect investors.

2. We are concerned primarily with the needs of private shareholders, but savers in collective schemes would also benefit from the existence of such a government body, with a consistent perspective of protecting the consumer's interests; for example:
   - determining who owns the 'orphan assets' of life assurance companies;
   - ensuring that the conversion of building societies and mutual assurance funds to limited companies is fair to existing members;
   - considering how financial services commissions should best be regulated;
   - ensuring that investment trusts boards are genuinely independent;
   - monitoring the effectiveness of the 1995 Pensions Act.

4. REGULATING THE STOCK EXCHANGE

1. Most people assume that the Stock Exchange is a public body. In fact, it is a private club open only to industry practitioners; this, combined with its roles as an effective monopoly and as a regulator, creates major conflicts of interest.

2. In recent years, the Stock Exchange has not handled these conflicts of interest well. It has tried to obstruct the development of competing trading services such as Tradepoint; it has also consistently placed the interests of its members above those of private investors:
   - In 1996, it effectively ended equal access to New Issues of shares, locking private investors out of most new issues;
   - It now plans to exclude most private share deals under around £4,000 from order-based trading when that is introduced in October 1997, forcing us to continue using the old,

inefficient and expensive market-making system; private investors will pay extra so that marketmakers may continue to do business;
- It has also sidelined proposals for the clear declaration of directors' pension benefits, in favour of a proposal that will allow directors to hide behind figures that are, quite intentionally, meaningless to most investors.

3. These major instances demonstrate that the London Stock Exchange, in its present form, has difficulty in acting as a responsible and impartial regulator. A review of its regulatory powers is essential.

5. BUILDING FINANCIAL LITERACY

1. As the future well-being of all citizens becomes more dependent on the successful investment of their savings, there is an increasing need to equip them with at least a basic level of financial literacy; for example, an understanding of:
   - the levels of saving needed to provide for old age;
   - the risks, rewards and mechanics of various forms of saving;
   - the appropriate forms of saving for differing requirements;
   - the principles of compound interest and the consequent impact of costs, performance and inflation on long-term savings.

2. At present, most citizens approach their most important financial decisions in a state of ignorance, and many spend the rest of their lives paying for early mistakes. Many will never make adequate investments because they fear what they do not understand. Many savers in strongly promoted PEPs do not appreciate that the tax savings are frequently outweighed by the charges levied. Far too many citizens leave all their funds in the bank or commit themselves to highly expensive and inflexible savings vehicles - both of which can be disastrous in the long term - because of a lack of financial literacy and confidence.

3. Measures should be taken to promote financial literacy. A department of savings and investment could play an important role in ensuring that this forms part of the educational curriculum at all levels, with the main emphasis being firmly on the interests of consumers rather than those of the finance industry. It is critical that the industry should not be in a position to determine educational content.

6. ENDING ANTI-COMPETITIVE PRACTICES IN FINANCIAL SERVICES

1. Shareholders and consumers of investment products have been seriously disadvantaged, over many years, by the lack of a truly competitive market in investment services and vehicles. It is essential that a genuinely competitive market should be established, to protect investors from excessive fees and inadequate service.

2. High exit fees and hidden exit barriers are rife in the savings and investment industry. These prohibitive costs lock investors into schemes that are not inherently competitive. These costs can apply to everything from pension schemes and endowment policies to nominee accounts; they are fundamentally anti-competitive, and need to be tightly regulated.

3. Effective competition cannot develop unless there is full disclosure of costs, and separate disclosure of commissions, in a consistent, appropriate and readily understood form. New charges, or increases to existing charges, need to be preceded by statutory notice periods.

7. SIMPLIFYING TAX-FREE SAVINGS SCHEMES

1. Savings schemes need to be encouraged through tax incentives. The patchwork of schemes that has built up over the years needs to be simplified: it is too forbidding, too restrictive and too expensive, and much of the tax benefit is swallowed by intermediaries.

2. The benefits of General PEPs, Single Company PEPs, Venture Capital Plans, TESSAs and other schemes - all restricted to specified types of investment - need to be brought together to provide maximum flexibility at minimum cost. The basic principle should be that citizens are encouraged to provide for the future by investing a reasonable amount of money over time under a savings umbrella, free of tax, and with minimum restrictions on how we tailor our savings and investments to our changing needs. In particular, schemes should allow savers to invest directly in equities and retain their full rights as shareholders. The same principles should apply to Self-Invested Pension Plans.

8. ENCOURAGING DIRECT SHARE OWNERSHIP

1. Most investments are now channelled through collective schemes. That suits many people, but savers in collective schemes lose out badly, through the cumulative impact of costs and charges over many years. They have no opportunity to determine what sort of companies are supported by the funds they provide, or to exercise their responsibilities as owners.

2. Yet many savers are discouraged from direct investment in companies by a tax system that discriminates heavily in favour of collective schemes, by the complexities of Capital Gains Tax, by the Stock Exchange's discrimination against direct shareholders and by a lack of knowledge and confidence in financial affairs.

3. Various measures can and should be taken to encourage direct investment:

- Direct investment should not be discouraged by the tax system.
- The right of equal access to new issues of shares for all investors, removed by the Stock Exchange in January 1996, should be restored.
- The benefits of order-based trading should be made available to ordinary investors, not just institutions and the very wealthy.

- The Stock Exchange, and CREST, should not discriminate against shareholders who wish to retain their full rights as shareholders.
- Financial literacy should become a part of the educational curriculum at all levels.

9. MAKING FUND MANAGERS MORE RESPONSIBLE TO THEIR INVESTORS

1. Most UK shares are owned by collective funds on behalf of private investors. And yet fund managers have until recently failed to recognise their growing responsibility as effective owners of a large part of British industry.

2. Recently, some fund managers have made efforts to improve standards of corporate governance, and to take a more active role in encouraging or enforcing change where a company's board is ineffective, corrupt, or pursuing strategies that are against the long-term interests of the company.

3. We welcome this, but we believe that institutions with significant shareholdings should themselves be made more accountable to their own investors; fund managers with shareholdings over a certain level (say 3% of a company's voting capital) should:
   - be encouraged to make public the policies (for example, over remuneration and provision of information to shareholders) which they expect companies to follow;
   - have their votes or abstentions published in the Company Announcement following any vote of shareholders;

4. We do not support measures requiring institutions to vote for or against resolutions put to shareholders - the natural tendency would be to follow the company board's recommendation in most cases as a matter of course: institutions must be able to abstain on a vote of shareholders.

10. RESTORING THE RIGHTS OF PRIVATE SHAREHOLDERS

1. The reduction in settlement times under CREST, penalties for late settlement, inertia selling and the restriction of many broker services (such as access to new issues) to nominee account-holders are increasingly pressuring many private shareholders into holding their shares in nominee accounts or under sponsored membership. This is popular with brokers as it effectively ties shareholders to a single broker and provides a steady stream of fee income at the shareholders' expense. For investors in self-select PEPs and similar schemes, nominee accounts are the only option: sponsored membership or share certificates are simply not on offer.

2. The pressures to move into nominee accounts have resulted in the disenfranchisement of a large and growing number of private shareholders: we have ceased to be the legal owners of the shares, and it becomes difficult or impossible for us to exercise our rights as shareholders, to raise motions, to stand for election, to attend and speak at general meetings,

to receive company information and to receive shareholder benefits. As a result, it is often very difficult for shareholders find out the true state of affairs in our companies, or to exercise our responsibilities as owners. The failure to address these problems long ago is symptomatic of an industry that has been governed primarily for practitioners, not for consumers.

3. There are various possible approaches, some of them complimentary, to the problems of nominee accounts:
   - Considering the US model, where shareholders' rights appear to be effectively preserved within the equivalent of nominee accounts.
   - Restoring our legal ownership of shares held in nominee accounts.
   - Restoring full ownership rights over shares held in nominee accounts: to vote, to attend and speak at general meetings, to receive shareholder information (annual/interim reports and company announcements) and to receive shareholder benefits.
   - Making the new 'name on register' facility under CREST available to shareholders in nominee accounts, as it is for sponsored members.
   - Allowing self-select PEPs and similar schemes to be held in sponsored membership accounts.

11. CREATING EQUAL ACCESS TO COMPANY INFORMATION

1. The manner in which company information is treated needs wholesale reform. At present, the emphasis is overwhelmingly on the interests of investment practitioners through such arrangements of private briefings for institutions and analysts, rather than on the needs of all owners of the company for full, up-to-date and meaningful information. While attention is paid to trying to prevent leakage of price-sensitive information, this frequently does not work in practice - as is clear from the price movements that precede many major company announcements.

2. We need to move from a culture of concealment to a culture of disclosure.

3. Private shareholders are also disadvantaged by the way in which company announcements are made: the Stock Exchange appears to regard these as a revenue-generating opportunity, not as public information to which all investors are entitled. Official company announcements should at the very least be available in full, free of charge, on an accessible and non-copyrighted Internet-based news service.

4. Company announcements should be made after normal trading hours, where possible, so that professional and institutional investors are not able to deal on the basis of information before it has reached other shareholders.

5. Annual and Interim Reports generally reach shareholders far too late, weeks after they have been officially announced (and distributed to city analysts), and 3 to 5 months after the end of the period reported. Annual Reports are used as an important promotional tool for

companies, but their role as a source of timely information to shareholders has been effectively abandoned. In recognition of this dual role, Audited Accounts and Provisional Reports, as currently disclosed to analysts, should be published on the Internet at the time of disclosure.

12. MAKING DIRECTORS MORE ACCOUNTABLE TO SHAREHOLDERS

1. Private shareholders at present have too little opportunity to call ineffective or self-serving directors to account. Institutional investors have only recently recognised their responsibilities in this area. We welcome recent initiatives by institutional investors: in the long term, the active involvement of institutional investors can improve the quality of management of British companies, to the benefit of both shareholders and industry.

2. However, directors' responsibility and accountability to **all** shareholders needs to be re-established. We welcome recent initiatives encouraging companies to make AGMs and EGMs more meaningful, from the City/Industry Working Group (the Myners Report) and others.

3. AGMs and EGMs have become almost irrelevant to many companies' affairs, depriving private shareholders of their one opportunity to hold directors to account. It is almost impossible for private shareholders to put resolutions for consideration at a General Meeting; most institutions have held private discussions with management in advance of the meeting, and have lodged their proxy votes, so that the result of a vote has been determined behind closed doors long before it is debated by private shareholders; many chairmen fail to recognise the right of shareholders at meetings not just to ask questions but to 'speak to' resolutions; and investors in nominee accounts have difficulty in attending, voting or speaking. In addition, too many AGMs are held on the same date, precluding attendance by private shareholders at many meetings.

4. Political contributions (if any are intended) should be subject to annual approval, as they are for trades union members.

5. 'Insulated directorships', which remove the need for company directors to stand for election on a regular basis, should be abolished.

6. 'Composite' motions, which allow companies to put essential company business and controversial issues to a single vote, should be abolished.

7. Directors can effectively award themselves excessive salaries on lengthy rolling contracts: the rewards for failure are a massive and immediate pay-out, and there is little incentive to succeed. An annual vote approving any increase in total board remuneration - inclusive of all fees, awards and pension costs - should be mandatory; the maximum duration of fixed or rolling contracts should also be subject to an annual vote.

8. In many companies, incentive schemes for directors have lost all contact with reality: the potential rewards of options and LTIPS can be deeply obscure and can be out of all proportion to a company's size or profitability. Performance targets are frequently undemanding and there are instances where these targets are rebased each month so that their non-achievement becomes almost impossible. Incentive schemes should be subject to much greater scrutiny to ensure that they are genuinely linked to real performance. Any that cannot be valued at the time of granting should be abolished.

9. Finally, company directors must be made more accountable through reform of the election process, as described below.

13. REFORMING THE ELECTION OF DIRECTORS

1. Currently, directors are effectively selected by the existing boards, except where pressure is successfully brought to bear on the board by substantial shareholders. Elections are a fiction: the existing board generally nominates all of the candidates. As a result, the detached and committed appraisal of company management by the directors not involved in the day-to-day running of a company is frequently missing, and it is extraordinarily difficult for shareholders to dislodge bad or mediocre managements who are determined to remain, except through a hostile take-over.

2. Non-executive directors are frequently far from independent. The intention of the Cadbury Committee was that they should represent the interests of shareholders; in fact, they are usually appointed by the board and are effectively answerable to the board. As a result, examples of watchdogs that fail to bark, with dire consequences for share value, are legion. The question of how genuinely well-qualified, committed and independent directors are to be brought onto company boards has not yet been addressed.

3. We believe that the best means of achieving capable and truly independent directorships, and of enabling shareholders to improve the quality of inadequate managements, lies in a reform of the electoral process.

4. The principle of direct election is fundamental: all board members must be subject to election and periodic re-election by the shareholders; but the electoral process has little meaning if shareholders have no way to judge the calibre of candidates other than the board's recommendation and a few words of biographical detail.

5. Further debate is urgently needed, to examine ways in which electoral process can be made more meaningful and the nomination process for independent directors can be broadened out.

14. TAKE-OVER POLICY

1. Take-over regulation should be primarily concerned with ensuring that the interests of minority shareholders are protected, except in those cases where the country's interests are clearly affected, where monopoly considerations apply or where consumers are put at risk.

2. In most instances, shareholders in a target company must decide on balance whether to support the existing management or the aggressor. However, the potential benefits of most take-overs cannot be 'proven' until months or years after the event, so requiring that an aggressor prove the benefits of a take-over would make contested take-overs virtually impossible.

3. Contested take-overs are the ultimate sanction against ineffective or corrupt managers, when all else has failed. As such, they are an essential aspect of the competitive market: investors must be able to protect themselves effectively from bad management.

4. This is even more important for members of recently-converted life assurance companies. Members who are committed to long-term savings schemes (mostly through pensions and endowments) are likely to lose out through poorer performance, since non-mutual, or proprietary, life assurance funds are consistently outperformed by mutually-owned funds. Compensation consists of the shares in the newly-listed company, and the performance of those shares - and the savings schemes - is at the mercy of the management. The 5-year protection rules leave members with no protection against inadequate or self-serving managements, and should be abolished unconditionally.

15. REFORMING THE ROLE OF EXTERNAL AUDITORS

1. The annual accounts can be a haven for dubious and creative accounting practices that can hide the state of a company's health from its owners, resulting in some of the major company scandals of the last decade. Great improvements have been seen recently, but the basic conflict remains: external auditors are effectively answerable to the board, and not to shareholders.

2. The role of external auditors as watchdogs for the company's owners should be emphasised, and the profession made subject to more effective, independent regulation, to ensure that the highest standards are maintained.

3. We propose two further measures:
   - External auditors who are appointed to carry out a company's statutory audit should be banned from providing any other services to the company;
   - External auditors should be made liable to shareholders, reversing the effect of the Caparo judgement.

16. PROTECTING PRE-EMPTIVE RIGHTS

1. We would welcome measures to introduce genuine competition into the underwriting process. However, pre-emptive rights are a fundamental protection of a company's existing investors, and must not be diluted or abandoned. The 'cost of capital' argument against rights issues is essentially spurious: rights issues are not only the best way of raising capital but, in most cases, the cheapest.

17. REGULATION OF UTILITIES

1. Regulation of monopoly bodies (which covers most utilities) needs to fair to shareholders and customers. It needs to be consistent, both between different industries and over time. The present system is too focused around individuals, and too vulnerable to violent mood-swings. Agreements entered into by regulators should be honoured, for the full term of the agreements.

2. RPI-X, when applied properly, creates a healthy environment where companies are constantly obliged to improve their services and reduce their costs. However, the greater cost savings achieved by the most effective company managers must not be taken by the regulator or the taxman; there must be an incentive for managers to perform, and for investors to jettison incompetent managers.

3. Expected return on investment must be sufficient to justify the investments, in commercial terms; otherwise, investment in utilities will collapse, creating a slow decline in the quality of the services provided.

4. Ultimately, the consumer of utilities is best served by competition, wherever it can be created. But competition will not develop where the original provider is so tightly squeezed by the regulator that there is no prospect of a reasonable financial return for new competitors. And the consumer is not well served where there is no competition and the only service provider is unable to invest in maintaining or improving the services.

18. FINANCING OF SMALL BUSINESS

1. Small businesses need private investors - whether as 'angels' to start-up companies or providing liquidity in the junior stock markets. Most larger institutions are unwilling to invest small sums in large numbers of companies. Smaller investors, with the ability to sustain liquidity and the readiness to research and invest in very small companies, can fill the investment gap.

2. Recent development of 'junior markets' catering to the needs of smaller companies will have a long-term impact on the nation's success and prosperity, and should be encouraged - including markets that compete with the London Stock Exchange

3. However, it is crucial that liquidity is created when smaller companies are listed, by ensuring that private investors have equal access to initial share offerings. Equally, liquidity will not be sustained in the after-markets if private investors incur massive dealing costs whenever they buy or sell their holdings. Junior markets that continually suffer from illiquidity will have difficulty in attracting fresh funds, and will not prosper over the long term: equal access for the private investor is crucial to their success.