UKSA
UK Shareholders' Association

THE PRIVATE INVESTOR

ISSUE 199 | APRIL 2019

A new era for UKSA

UKSA held its AGM in London on 2 April. It was the first AGM to be presided over by UKSA's new chairman, Colin Colvin.

Colin gave a presentation on UKSA's Strategic Plan, which was drafted following the Board's review of UKSA's main objectives, key success factors, strengths, weaknesses, opportunities and threats for the future and the key issues to be resolved.

Members were invited to contribute ideas for inclusion in the final draft of the Strategic Plan due this summer, in areas such as information provision for members, lobbying of business and government and the hosting of meetings and events.

Turning to the representation of individual shareholders in the UK, Colin noted that ShareSoc had restated its interest in a merger with UKSA and that the UKSA Board had responded positively. A joint organisation could provide greater resource and authority, enabling more effective lobbying. An initial meeting of Board representatives of the two organisations will be arranged.

The members of UKSA's expanded board then gave presentations on their respective areas: Peter Parry on Policy, John Hunter on Finance, Rob McDonald on Membership, Sue Milton on External Relations, Helen Gibbons on Europe and Media and Martin White on Savers Take Control (STC). Martin's presentation included a detailed progress update on the STC project, part of which is reproduced on page six of this edition.

All new and existing directors offering themselves for election or re-election were elected unanimously.

Turnout at the AGM was good and the engagement from members was excellent.

Against the backdrop of declining attendance at company AGMs, there was a lively discussion on the value of members attending AGMs and asking pertinent and challenging questions. This could generate more intense media attention on issues facing investee companies and ensure that boards stayed focused on the concerns of individual investors.

Colin Colvin, UKSA's new Chairman

In this issue

Published by United Kingdom Shareholders' Association Limited (UKSA)

Registered in England no. 4541415

Registered office: Chislehurst Business Centre 1 Bromley Lane, Chislehurst, BR7 6LH

Tel: 01689 856691
E-mail: uksa@uksa.org.uk
Website: www.uksa.org.uk

Chairman:
Colin Colvin chairman@uksa.org.uk

Policy Director: Peter Parry
01604 830267 policydirector@uksa.org.uk

External Relations Director:
Sue Milton sue.milton@uksa.org.uk

Company Secretary and Membership Director:
Rob McDonald uksa@uksa.org.uk

Europe & Media Director: Helen Gibbons
07876 231232 bizlang@mac.com

Administration:

Riches Assured Financial Services Ltd

01689 856691 officeatuksa@gmail.com

Editor: Helen Gibbons
07876 231232 bizlang@mac.com

Regional Contacts:

London & SE: Harry Braund
020 8680 5872 harrycb@gmail.com

South West and Midlands: Peter Wilson
01453 834 486 or 07712 591 032
petertwilson@dsl.pipex.com

North East: Brian Peart
01388 488 419 brianpeart@btinternet.com

North West: Julian Mole
07870 890973 julian.mole@btinternet.com

Privacy

UKSA takes your privacy seriously. Following the entry into force of the General Data Protection Regulation we have assessed our procedures to ensure compliance and have updated our Privacy Policy, which can be consulted on our website. Click here if you are reading the electronic version of this edition.

General information

Advertisements in The Private Investor will be clearly described as such where they are for paid-for products and services from third parties; advertorials will not be accepted. The Private Investor will not endorse advertisers and the editorial policy will continue to be independent of the interests of advertisers.

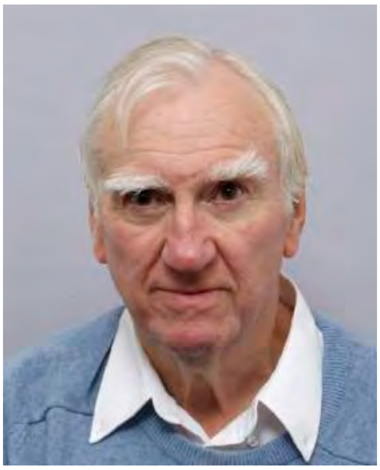
Revenue raised from advertisements will supplement UKSA's funds. UKSA believes that its members are capable of deciding whether an advertised product or service is suitable for their needs.

Note that the share-price graphs are courtesy of the leading investment website Digital Look www.digitallook.com.

Views expressed by contributors are not necessarily those of the editor or of UKSA. Nothing in this newsletter is intended to be or should be interpreted as investment advice, which can only be obtained from persons authorised in accordance with the Financial Services Act 1986 and subsequent legislation. Contributors and members may be invested in any of the companies mentioned.

Prudence – a false dawn

by Malcolm Howard



The concept of prudence is very simple. It merely states that assets cannot be overstated and liabilities cannot be understated. We were promised by the IASB that with effect from accounts published in 2019 the prudence concept (missing since the introduction of the IFRS accounting system) would be brought back.

The initial signs were good. On Wednesday 28 November 2018 the shares of the AIM-listed Staffline Group plc hit an all-time high of 1,344p for 2018, having been as high as 1,623p in 2016. On 9 January 2019 the company issued a statement: *"Staffline, the Recruitment and Training Group, is pleased to report that trading for the financial year ended 31 December 2018 is expected to be in line with market expectations. Revenues are anticipated to be around 18% higher than the £957 million reported in 2017."*

The trading update continued in that vein with the prospect of continued growth, both organic and through acquisition. The statement went on to say that the Group remains highly cash-generative, but due to acquisitions net debt at 31 December 2018 was expected to be around £63 million (as against £16.5 million at the previous year-end). A presentation to private shareholders was to be held on 31 January 2019.

At this date (9 January 2019) the shares were trading at 1,040p, but then they started to fall slowly, going back to 970p on 15 January 2019. Then, on 30 January 2019, the company said that the presentation was being delayed and would be rescheduled. The shares promptly fell to 670p. This statement was quickly followed up by the company advising that the auditors were concerned about invoicing and payroll practices within the Recruitment Division. Clearly, the directors could not understand what was going on. They said: *"The Board is confident that its policies in relation to these matters are appropriate, given that these practices have been the subject of prior audits."*

The Board admitted that the problem might be serious. They wrote: *"However, if the allegations are substantiated this could have a material impact on the Group and its profitability and until further investigation has been undertaken the Board cannot assess the potential materiality."* The shares were duly suspended.

The note continued that the company had in July 2018 refinanced its £150 million of lending facilities and this was well above the forecast net debt at the end of the year. What we don't know at this time is whether reduced profitability will mean breaching a bank covenant. For those neutral investors not holding these shares, it all becomes interesting.

Is this an indication that dubious practices in the past will no longer be tolerated?

I thought that at last the auditors had done some auditing. Maybe they had discovered that sales were being taken early. But, alas, no! As usual, they had discovered diddly-squat. What had happened was that an anonymous whistleblower had made allegations that caused an investigation to take place. It was found that the company had not complied with the 2015 National Minimum Wage Regulations in a limited number of food preparation facilities, because employees had not been paid for preparation time, which is generally the time spent donning workwear. A provision of £4.4m was to be made in the 2018 accounts.

On 13 March 2019 the suspension was lifted and within a few days the shares had moved to 840p from their price before suspension of 670p, but still well below the 2018 high.

On 8 March 2019, the Board of Goals Soccer Centres plc announced: *As part of a review of the results for the financial year ended 31 December 2018, the Board, together with the Auditors, are working to resolve certain accounting errors, and are reviewing some accounting practices and policies. It is likely that the Board will take a more prudent approach for the 2018 full-year results and that the reporting date (previously 12 March 2019) will be delayed.*

While the majority of these accounting adjustments are of a non-cash nature, this does nevertheless mean that the company will have exceeded one of its banking covenants at 31 December 2018. We are in discussions with the bank with a view to agreeing renegotiated *facilities.*

Following this announcement the shares fell 32% to 38p. Then, on 27 March 2019, it got worse: *The Board has concluded that there has been a substantial misdeclaration of VAT, going back over several years. The final value of the misdeclaration has still to be established, but currently the figure stands at approximately £12.0 million. The company also expects that the VAT accounting policies they intend to adopt may have an impact on profitability going forward.*

The shares were duly suspended.

On 11 October 2018 the Board of Titon Holdings announced that it planned to cancel its shares on the main market and move to the AIM market. It wrote: *The Board considers that the move to AIM is in the best interests of the Company and its shareholders. The Board believes that AIM provides a more suitable regularity environment for a business of Titon's size and structure, and provides more flexibility in relation to corporate transactions and equity fundraising.*

AIM is a very volatile market and some who trade on it take advice from what Boards write. So, following the announcement the shares shot up from 170p to 212p.

It cannot be explained why a move away from the main market often signals stormy weather ahead, but it often does.

On 14 February 2019 the company said that the trading performance in Titon Korea for the year ended 30 September 2019 was expected to be below market forecasts and the shares shot down from 202p to 124p. But the market believed that this fall had been overdone and the shares went back to 163p.

Then, on 19 March 2019, the company announced that its profits as shown in the 2018 Annual Report had been overstated by £1.1 million; this would be corrected in the 2019 Interim Statement. By then, the end of March, the shares were back down to 121p.

So it appears that accounting errors will be corrected (presumably in light of the Patisserie Holdings plc fiasco), but there is evidence that accounting will be as imprudent as ever. One of the ways companies can inflate their profitability is through capitalising expenditure on the grounds that such expenditure generates future income. But this is often spurious, as there is little or no evidence that creating such intangible assets will have sufficient effect on growth. The valuation of intangible assets often ignores the concept of the 'product life cycle'. This demonstrates that when a new and innovative product is introduced to the market it will initially grow quickly. After a time, growth slows, but volumes are still increasing. This is the time a company should sell its product because, after hitting a peak, from then on it will be negative growth. An example of this is 'Costa Coffee'. The product was certainly past its peak when it was sold to Coca-Cola and in the circumstances the Board of Whitbread achieved a fantastic deal. Had this deal not been achieved, then the value of Whitbread's intangible assets would have had to be written down.

So the worry is that many valuations of intangible assets are imprudent and it could possibly get worse. In a 2019 working paper the Financial Reporting Council (FRC) issued a definition of Intangibles: *"Intangible factors that are important to an equity in its creation of value, whether or not they are secured by legal means and whether on not they meet the current definition of 'assets'."*

Obviously it can be argued that some intangible assets have a genuine value. 'Patents', for example, preventing the competition from directly copying a valuable product clearly have some value, but 'customer lists' in a competitive market cannot have demonstrable value as customers can move away. The concern is that the FRC, based on its proposed definition, will give companies a free hand to inflate profits.

Now, I have always realised that IFRS accounts were imprudent, but until I visited Hays plc with UKSA in mid-March I had never worked out how bad it really was. **To make this clear, Hays plc have acted with admirable prudence; they are looking after their employees.** In doing so they have demonstrated just how appalling accounting standards really are. In the latest Hays plc balance sheet (half-year to 31 December 2018) the pension scheme is shown to have a surplus (asset) of £19.2 million, so why are they paying £15 million per year into it?

Well, it turns out that for accounting purposes the value of the investments in a defined benefits scheme are calculated by discounting AA corporate bond yields irrespective of the assets held by the pension scheme, sponsor covenant etc. On the other hand, for an actuarial valuation the trustee negotiates with the company to agree the basis. It usually reflects a prudent assumption for the return on growth assets (equities).

Clearly, in the case of Hays plc the difference between the accounting method (imprudent) and the actuarial method (prudent) was significant. Now, as most pension schemes are in deficit, one wonders just what the true deficits really are. In my innocence I always assumed the pension deficits were based on actuarial valuations**. In my view, this is another nail in the coffin of IFRS accounting standards that are really not worth the paper they are written on.**

We are very grateful to Cliff Weight of ShareSoc for permission to reproduce the article below, which first appeared as a post on the ShareSoc blog.

The Unstoppable Glacier of Government's Concerted Actions?

by Cliff Weight, Director, ShareSoc

We sometimes see things changing at a glacier-like pace. But once a glacier starts moving it has huge momentum and is unstoppable.

My question is: is this metaphor applicable to the way Government is behaving with regard to business? The civil servants who drive Government policy transcend the short lives of Parliament. Taking this perspective what do we see? My take on this is as follows.

The Financial Crisis terrified nearly everyone. We stared into the abyss. We were lucky. We are not out of it yet. There were lots of people to blame.

The Bankers were clearly to blame. They were the first target. Government has sorted them out. The new FCA and PRA rules and regulations should ensure the Financial Crisis will never happen again.

The accountants and asset management industry were next on the blame list. But it has taken longer to get to them. The Kay Review (2012) laid out the problems and set the agenda. Progress has been at a glacial pace.

What is interesting is the sheer scale of the Government concerted action that is now going on.

We would expect the Treasury and BEIS (the Department for Business, Energy and Industrial Strategy) to be involved and they are.

The FRC, Brydon, Kingman and CMA have been reviewing auditing and accountants.

The FCA have investigated the asset management industry and reported on its high profits, excessive fees and poor value for money/ poor performance.

But there are many other Government Departments involved. One reason is the continuing bad headlines of business disasters, excessive pay, gender pay and the lack of diversity. This creates a lack of confidence in business from the general public. Arguably Brexit was an expression of unhappiness with the status quo from the electorate. The Government seems to have got it and is pressing for change from various quarters.

The Department for Digital, Culture, Media & Sport (DCMS) is working on gender pay.

The Department for Work and Pensions is working on value for money that pension funds get from their asset managers and the transparency of reporting back on performance and stewardship.

The Department for Environment, Food & Rural Affairs is looking at sustainability, which may impact ways asset owners invest in the future.

The Stewardship Code is being reviewed by the FRC, whilst the FCA enacts the stewardship parts of MIFID II into UK law and the FCA/ FRC are jointly reviewing stewardship in a wider sense and have launched a discussion paper (DP19/1) on this topic.

Our own flagship issue is restoring shareholder rights to individual shareholders, who have been disenfranchised by the nominee accounts system. There are signs that we may be making some headway, but it is still too early to make promises. However, The Law Commission Review is planning a Review of Intermediated Securities (in plain English Nominee Accounts, but it will also cover custodians, voting and plumbing). This is an important first step for us.

Please don't expect these changes to happen overnight, but there is evidence to suggest that the glacier is on the move and progress will happen.

STC – Savers Take Control: a report from the UKSA 2019 AGM

by Martin White

As most of you will know, this is a project to tackle two things:

1) The problems arising from the fact that individuals have to make sensible decisions in the face of a big disadvantage they have in relation to the financial sector. "Who to trust" is a big problem. This could be referred to as the "empowerment of ordinary individuals, in the face of the financial sector";

2) Helping ordinary people to understand and speak up about the way companies behave. This is the second theme.

STC **has** been progressing since our last meeting, but slowly and more behind the scenes than in the public domain. So you won't have heard much about it, and I apologise for that. I still have a full-time job, and every now and then that takes all my time.

As our Chairman has already mentioned, STC has been the subject of intense discussion in our board meetings. The immediate priority has been to ensure that we have information ready on our website that is clear and inviting but also appropriately measured and professional in style. In the near future, I plan to get some media coverage on STC – and for this to focus on one really radical idea, which is the first theme set out above.

- It will be a movement for savers and investors to help each other, which is itself a radical and exciting idea. First and foremost, how to save money when investing. In particular it will aim to teach people the damaging impact of annual percentage charges. Our complete independence from the financial sector is an important part of the message.

- And the main media message will be that we are aiming to help not just our current members, but anybody. I am hoping that some people, especially younger people, will be inspired by this message and contact us.

- When this launch happens, I am fairly confident that we will receive at least some support, in the form of words of encouragement, from outside our organisation.

- I can't predict at all what will happen when we do that media launch. It may get no traction at all. Or it may get lots of interest, and we need to be prepared for if and when that happens; one can't map out a precise plan with an enterprise like this.

Statement at the UKSA AGM

The above remarks are a pretty accurate reflection of my statement at the AGM. I got a very good question in response along the following lines: "If your ultimate objective is to help all savers, how are you going to access the mass of people who know very little and are not at all engaged?"

The answer to that is that, whilst we have the vision of being there to help everyone, we can't start like that. We have to do what is practical, which is to build our team of volunteers by attracting first those people who are already fairly financially sophisticated and who are inspired to join in a worthwhile movement.

A thought on company behaviour and culture

In a conversation over a drink after the meeting, on the subject of company behaviour, the topic of executive remuneration came up, as it often does. I have a view on this which is firmly held, but it goes against the grain of all the trends in remuneration of the last 30 or so years. I'd love to hear (through the editor) of your views on this.

One of the things which executive pay schemes have been intended to achieve is a focus on the company share price – to encourage them to behave in such a way that the share price rises in the short to medium term (no more than five years). I think this is appalling, and has unintended consequences, potentially including all the following:

- Boardroom time spent on share price considerations, public relations, media message etc. that should be spent on developing and implementing strategies that enhance the company's longer-term success;

- A damaging "shoot the messenger" culture, where people are afraid of speaking up because those at the top don't want to hear bad news. That is not a culture in which to encourage fully informed strategic thinking at the top, and not a pleasant culture for employees generally;

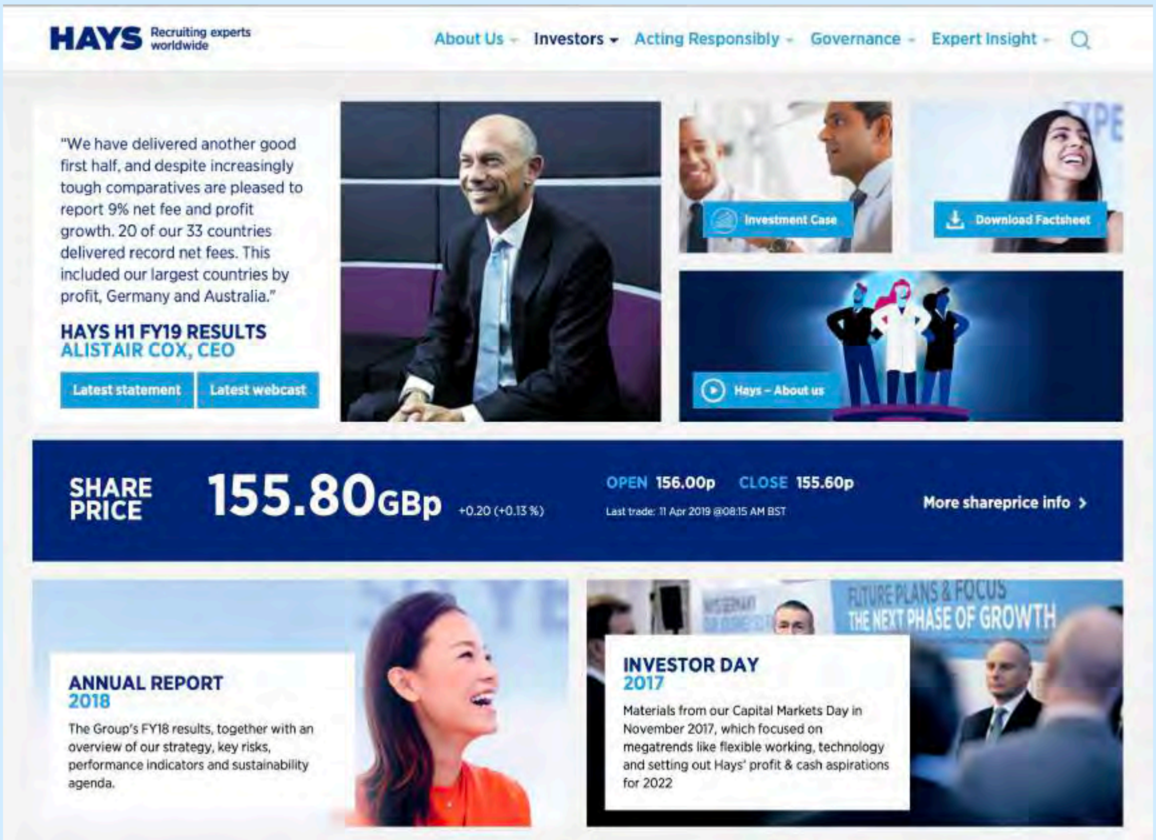
- A strong temptation to "make the figures" – creative accounting, let's call it;
- A tendency to avoid investment opportunities that don't have an immediate payoff;
- Long-term underperformance compared to competitors that focus on enhancing their relative capabilities as a strategic imperative, even though it may involve policies that reduce reported profit in the shorter term;
- Because of the poor flow of information upwards that the "shoot the messenger" culture causes, the board won't be in a position to communicate really well with the shareholders about the business, and ultimately trust will suffer.

Does any of this ring any bells?

We'd love to hear your thoughts and stories (printable, of course!).

Visit to Hays plc

Thanks are due to Phil Clarke for setting up an intitial presentation to members by Hays plc in March, which we hope will become a regular feature. This is a great example of the engagement UKSA pursues with groups likely to interest investors. A video aimed at investors can be found at https://www.haysplc.com/investors



The future of audit

The BEIS Select Committee chaired by Rachel Reeves MP has published a hard-hitting report (The Future of Audit) lambasting the disjunction that has been allowed to develop between International Financial Reporting Standards (IFRS) and English law. The report acknowledges UKSA's campaigning on this subject over many years.

Under the heading 'Accounting Standards and the Law' the Report concludes: '*We are alarmed and disappointed that the FRC has not provided clarity on these fundamental issues, given the potential and actual problems that have arisen.'*

Under the heading 'Prudence' the Report notes: '*At its heart, the divergence between IFRS and the law is that the overriding principle behind IFRS is neutrality, whereas the overriding principle behind the law is prudence. The two can be wildly different at times, as exemplified by Carillion. We cannot unilaterally reform the international standards, but we can ensure that prudence remains at the heart of the law. Prudence leaves companies better capitalised, and so more resilient to shocks.'*

These are matters on which a group headed by Natasha Landell-Mills of Sarasin & Partners, supported by UKSA and with particularly important input from Tim Bush of PIRC, have campaigned for many years. The stance of the Report is both a vindication of and a triumph for the determined campaigning of this group.

In the article below, the second in a series on IFRS, John Hunter addresses this fundamental incongruity.

IFRS: Act 2

by John Hunter

I began this series of articles in the October TPI with a complaint that I thought accountancy had lost its way but did not understand how or why. I resolved to educate myself and write for TPI as I went along. My last article had some comments on the background but I had not grasped the full story. This is the full story (or my version of it) and finally explains, I think, how things came to be as they are. And perhaps will help us to write another story, which is about putting them right.

We need to understand how a fellowship of honest, technically skilled and highly intelligent people – the UK accounting profession – has got into this bind. A little history is necessary. Yes, its USA vs UK again.

Once upon a time there were two countries – USA and UK – with two accounting bodies – Financial Accounting Standards Board (FASB, for the US) and Accounting Standards Board (ASB, for the UK, later absorbed into the FRC) – overseeing accounting practices in their two countries according to two sets of accounting principles – Generally Accepted Accounting Principles (GAAP, for the US) and Financial Reporting Standards (FRS, for the UK) suited to their two different styles of legal structure and corporate practice. It suited the US system to regard accounts as primarily a service to the capital markets, focussing on the providers of capital and the regulation of markets. It suited the UK system to regard accounts as primarily a service to shareholders, to enable them to exercise their stewardship responsibilities.

Capital markets are primarily interested in values, so that's the emphasis in US GAAP. The focus is more on the future (since it's estimates of the future that translate into today's values), less on the past. The focus is also more on the balance sheet, less on the income statement. The numbers in the balance sheet are nudged to approximate to 'value'. A set of principles has been developed to accomplish this called 'fair value accounting'. It all makes perfect sense within a US context.

However in the UK shareholders are primarily interested in stewarding performance, so that's the emphasis in FRS. The focus is more on the past, less on the future. The focus is also more on the income statement, less on the balance sheet. The numbers in the income statement are nudged towards preparing for the worst and not counting chickens before hatching. These principles were enshrined in the UK mantras 'a true and fair view' and 'prudence'. It all makes perfect sense within a UK context.

Both systems worked within their own jurisdictions. Then the cry went up for integration – for a single set of accounting rules applicable worldwide. It was a dream that particularly caught the attention of David (now Sir David) Tweedie of ICAEW. In 2001 his dream was realised, or at least given the vehicle to be realised, when the International Financial Reporting Standards Foundation (IFRSF) was formed, ***'to develop, in the public interest, a single set of high-quality, understandable, enforceable and globally accepted International Financial Reporting Standards (IFRS) based upon clearly articulated principles'***. Ominously for the future this was an American initiative incorporated in Delaware. The International Accounting Standards Board (IASB) was formed a month later as ***'the independent standard-setting body of the IFRSF'***. It replaced the London-based International Accounting Standards Committee. David Tweedie was the first Chairman and remained so for ten years.

But the fundamental difference in philosophy between the US and the UK was not to be addressed.

I became interested in this story after being introduced by Dean Buckner to the battles that went on in 2005-08 (and no doubt for many years after that) as the UK attempted to resist changes to IFRS that moved them to 'fair value accounting'. But I came to realise that the die was cast with the formation of IASB in 2001. Thereafter every major dispute was going to be eventually settled in favour of the Americans. It is noteworthy that:

- In the IFRS principles of 2010 the word 'prudence' did not appear.
- The word 'shareholders' was explicitly removed from the list of stakeholders at which accounts were aimed.
- The IFRS mantra became 'useful to users'– a self-evident but meaningless statement that allows the Americans to argue that the most important users are the capital markets.

What's wrong is that IFRS have become mismatched to the UK's well-established set of laws and regulations. As a practical matter we are stuck with IFRS for a while – it's mandatory for all quoted companies in the UK, and the labyrinthine governance of the IFRS foundation itself (see my article in the February TPI) would ensure that any change there would make Brexit look like a walk in the park.

But Carillion and its like have opened a window for us, bringing to public attention issues that are normally protected by what Adrian Phillips in his TPI article of June 2018 called the 'craft monopoly'. The UK profession needs to recognise its responsibility for the mess we are in and take a lead in matching reporting practices to the laws of this land, not some imaginary international construct, and we hope this will prove to be a wake-up call in that direction.

Click the image on the right for a video published by *economia*, in which Rachel Reeves MP speaks at the launch of the BEIS Committee's report, discussing the FRC, the break-up of the big firms and the "profound" problems with the audit sector.

RBS - signalling the demise of shareholder primacy?

by Sue Milton

How important is shareholder primacy? It has been the mainstay of our corporate world, with investors putting their capital at risk in return for a share of the profits based on the number of shares owned.

Now this is key: whilst the level of influence is also commensurate with shares owned, the right of each shareholder to receive information and vote on decisions is equal.
Bearing this in mind, one area where companies prefer to ignore shareholder concerns is corporate remuneration. The government, too, is concerned and that concern was a contributory factor to the 2017/18 review on corporate governance for "a sharper UK Corporate Governance Code to achieve long-term success and trust in business" (tinyurl.com/yarklqal). Government's aim included giving shareholders greater say on pay.

If you heard the Radio 4 programme of 26 March (unfortunately no longer available on the BBC website), you will be aware of the latest contradictions between MPs, who are calling for a crackdown on executive pay, and RBS arguing against shareholders questioning remuneration, with Government playing one side off against the other by being in favour of the principle of better shareholder engagement but shying away from any practical implementation.

The ultimate losers are shareholders. There is also a risk to shareholder primacy. How and why?

The trend of CEOs' increasingly generous pay packets, awarded even when there is underperformance, undermines value. RBS has a strong track record of doing just that, hence the joint ShareSoc and UKSA push for a shareholder committee within RBS.

On a positive note, the upcoming AGM will, once again, vote on the formation of a shareholder committee for regular dialogue with the board and executives. The downside is that RBS is, once again, campaigning against the concerns of a significant minority of its shareholders, people like us.

People Like Us are exactly the type of shareholder behind the idea of joint stock companies. We invest, taking a risk to receive a share of the profits. This direct investment is the basis of shareholder primacy, the ability to directly challenge company boards and hold board members to account. The link between direct investors, the board and the company is tight. The advent of nominee accounts and institutional investors has diminished that close link because most investors are indirect investors; they are not the registered shareholder. Shareholder primacy is now diluted, which is why RBS feels it can keep defending its position with negative statements rather than constructive argument.

This was reported on 24 March 2019, in the FT, when 'RBS said it did not believe creating a committee "would be in the best interests of the company"'. RBS's statement suggests that the interests of the board and senior executives trump shareholders' interests, making corporate ownership and stewardship irrelevant.

RBS does raise a point, seen as valid by Government, on 'the difficulty of finding a representative panel'. Wrong. Defining the range of shareholders is easy. I can tick off: private investor, nominee investor, employee shareholder, investment fund, charity, pension fund. Terms of reference are easy too. Start with:

- To understand the remuneration policy in relation to the delegation of duties from owners to the board and how success is defined.
- Membership is a representative from each class of shareholder, the Chairman of the Remuneration Committee, Senior Non-Executive Director.
- Meetings to occur in line with the various stages of the annual remuneration cycle.

And take it from there. The related questions are easy too:

- Why does the board think its remuneration policy is the right one?
- Explain the purpose and balance of cash, pensions, bonus, long-term incentives and the mechanisms of how and when these paid.
- How does the reward link to strategic and business objectives?
- What controls and challenges are there in place that influence the levels of remuneration actually given?
- How is brilliant effort in difficult times rewarded versus poor effort in easy times?

Thought and expertise need to combine for a workable framework together with the willingness to adapt the approach as we learn. None of this is reason enough to prevent us starting. After all, a lot of business decisions are surrounded by difficulty but are implemented, warts and all, because of the intended benefits. The balance of risk/control/value applies to governance aspects as much as money-making ventures. The quality of corporate governance supports the quantity of profit. RBS's past has shown the destruction of the latter when the former is ignored.

As to shareholder committees '"undermining" the unitary board structure', the RBS board has done that unitarily most successfully.

Other than direct investors, all other shareholders have some conflict of interest. For example, we have to rely on the quality of stewardship provided by investment funds, patchy at best, and another area of concern, hence the current review of the stewardship code (tinyurl.com/y2lvk95p). Nominee account holders are not the registered shareholder, so have no ability to directly access shareholder information relying, instead, on what the nominee company choses to divulge. The unintended outcome of investment via a third party has led corporates into believing all investors have abdicated responsibility over governance.

Going back to Radio 4's recording, comments made included concerns over the failure of investment funds to challenge company boards and that stewardship had no lasting impact. RBS's approach illustrates the failure by investment funds and nominee companies to hold boards to account. By side-lining People Like Us, any chance of retaining shareholder primacy is compromised. Until the influence of direct and indirect investment is recalibrated, equitable treatment, fairness, good governance and long-term value all suffer.

Conference on audit reform

In the wake of the BEIS Committee's Future of Audit Inquiry referred to on page 6, UKSA was represented at a conference in April hosted by City & Financial. UKSA's chairman Colin Colvin took part in the panel and there was further high-quality input from Peter Parry and Sue Milton. Representatives of BEIS and the London Stock Exchange expressed the hope of further engagement with UKSA on the issues raised. A full report will appear in the next edition of TPI.

In this edition of The Private Investor we are delighted to include an article by Dr Quintin Rayer, who is Head of Research and Ethical Investing at P1 Investment Management*. We are keen to boost our coverage of ethical and sustainability issues, so hope to include more contributions from Quintin in the future.*

Introducing Ethical Investing

Dr Quintin Rayer
DPhil, FInstP, Chartered FCSI, SIPC
Chartered Wealth Manager

Biography

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

Introduction

Ethical investing has become a growing area of interest in recent years, with terms like ‘sustainable’ or ‘responsible’ investing also common. While the terminology can seem confusing, behind it lies a straightforward idea; money can be invested both to generate returns and do good (or at least minimise harm).

Ethical investment may be seen as falling into the ‘nice-to-have’ but non-essential category but is actually crucially important. It permits anyone with savings, including in pensions, to contribute to the betterment of society or to help with environmental issues including global warming. This becomes clear by exploring the relationship between sustainability and finance, which, in turn, sets the background for ethical investing.

Unsustainable human activities have generated threats including climate change (associated with rising sea levels, extreme weather and flooding, for example) resulting in damage, loss of life, and disruption to food and fresh water supplies. Lengthening life-span means demographics will have an impact on healthcare and pension costs. More of a growing world population will demand improved living standards as less developed countries modernise. Responsible investors argue that behaving unsustainably will cease to be an option.

The Role of Companies

Corporations are ubiquitous and powerful, with a truly international presence. Humanity needs them to end unsustainable behaviours and tackle future challenges. These may include environmental problems, climate change and social issues. Regrettably, part of industry’s dynamism comprises the externalisation of costs on to the environment, communities, employees or future generations [1].

Financial markets play a role in helping to both support and control corporate behaviour. Markets reward ingenuity, efficiency, talent and productivity through the ability to raise funds from share and bond issuance, as well as by valuing companies through share pricing. Companies making far-sighted investments tackling these problems will benefit in either the short or longer term, making them valuable investments.

Since corporate activity is an essential part of human activity and development, sustainable investment also requires that companies generate economically sustainable long and short-term returns. This counters short-termism, in which immediate profits are made at the expense of damaging longer-term profitability.

The Modern Business Environment

In today's environmentally and socially aware business environment, there is an appreciation that:

- Companies taking environmental risks have historically caused disasters (e.g. oil spills, deforestation, mining pollution).
- The social costs of business practices can no longer be ignored, as in previous eras (for example, the slave trade). Public tolerance of unacceptable worker conditions has diminished (e.g., mining and child labour).
- Companies require effective governance to confidently develop, meet legal and ethical requirements, and be accountable to stakeholders, including owners and shareholders. Corruption facilitates losses and sub-optimal decision-making. Poor oversight encourages high-risk behaviours and damaging scandals; potentially undermining reputations of entire industry sectors. For example, the banking and finance LIBOR scandal [2].

In the modern technologically-enabled world, environmental, social and governance failures are readily exposed, rapidly achieving global media coverage. Failures can result in financial losses, adverse litigation, reputational damage and clients taking business elsewhere. This can cause enormous damage to companies' values, share prices and even long-term survival.

Thus, ethically and sustainably orientated companies can target higher long-term profits by addressing pressing challenges while avoiding failures. At the same time, they accumulate marketing advantages and loyal customers as a result of their ethical behaviour.

Why this Matters

Many individuals are motivated by recognising the challenges facing humanity (and other species) as a result of threats such as climate change, as well as many social issues. Global awareness of corruption also raises recognition of the importance of good governance.

Individuals understand the importance of ethical issues and extend these considerations into ever-increasing aspects of their lives. Beyond retail consumer decisions, more people are using ethical considerations to guide their investments as well. In January 2019, according to the Investment Association, there were £16.8 billion of assets in the UK ethical funds sector, an increase of £0.7 billion since January 2018 [3].

Ethical investors select companies that help tackle the challenges of environmental, social and other problems while avoiding companies that engage in unsustainable or harmful behaviours. They use the influence of financial markets to reward companies with positive behaviours while reducing capital available to those participating in unacceptable activities. Selection of individual companies to support can be targeted in line with specific ethical objectives. Individuals can direct their savings into ethical investment funds, and can often make decisions regarding pensions savings so that these are also invested ethically. In short, ethical investors seek to "do well, while doing good".

Footnotes

[1]

J. Porritt, "The world in context: beyond the business case for sustainable development," Cambridge: HRH The Prince of Wales' Business and the Environment Programme, Cambridge Programme for Industry, 2001.

[2]

BBC News, "Libor scandal timeline", 2013. [Online]. Available at: http://www.bbc.co.uk/news/business-18671255. [Accessed 19 July 2017].

[3]

Investment Association, "PDF ARCHIVE OF STATISTICS," January 2019. [Online]. Available at: https://www.theinvestmentassociation.org/fund-statistics/full-figures/. [Accessed 25 March 2019].

We are very pleased to include the following article by Keith Hiscock and Yinghen Chen. We are indebted to Hardman & Co for permission to reproduce this article.

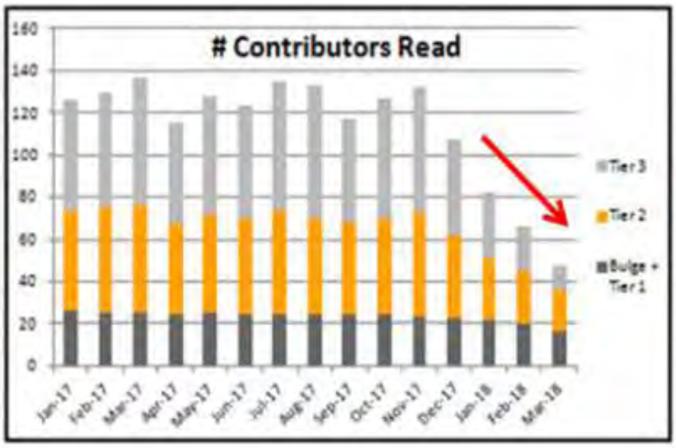
MIFID II: focusing on the number of analysts is only half the story

by Keith Hiscock and Yinghen Chen

Most of what has been written about the new environment for investment research has centred on the number of analysts per stock. Indeed, Hardman & Co has been at the forefront of exploring this impact and any consequent effect on liquidity with our own 'MiFID II Monitor'. But the more crushing, and far less appreciated, outcome has been on the distribution of broker research. Many brokers have seen their reach go from universal to 'tight'. This has destroyed the 'Age of Consensus'.

Collapsing distribution of broker research

Figure 1: Thomson Reuters: Decline in entitled sell side contributors



Source: Thomson Reuters

Figure 1 shows that the average top 12 institutional client of Thomson Reuters had access to the research and forecasts of 130 brokers (on a pan-European basis) before MiFID II in November 2017, and about 50 by March 2018. This confirms the dramatic change in the audience for broker research.

Forecasts in the 'Age of Consensus'

A further way to judge the decline of distribution is to look at forecasts.

Before MiFID II came into force institutional brokers and investment banks bombarded professional investors with research, forecasts and services. Institutions were happy to receive all of this because it was free!

In terms of forecasts it meant that these fund managers were all looking at the same screen. Every professional could see every forecast for every company, and how it compared to the peer group, i.e. the consensus. A few analysts built reputations for being the most accurate forecasters on a particular stock or sector.

The new world of non-consensus

MiFID II has destroyed the concept of a common consensus. Institutions now only see the research they pay for (with two exceptions). Receiving research without paying for it is an offence. The forecasts Fidelity can see might be completely different to BlackRock, as could the average. We have seen a growth in 'hidden forecasts'.

The two exceptions when research can be received for free include a short trial period and research paid for by the company (clause 12.3

of MiFID II). This covers research written by the house broker and sponsored research houses, such as Hardman & Co.

Retail investors never saw consensus anyway

The retail investor remains a second-class citizen, relying on bulletin boards and chatrooms, or crumbs from the institutional table, such as when the Times might report a JP Morgan upgrade. The only research and forecasts they have access to comes from sponsored research houses, such as Hardman & Co.

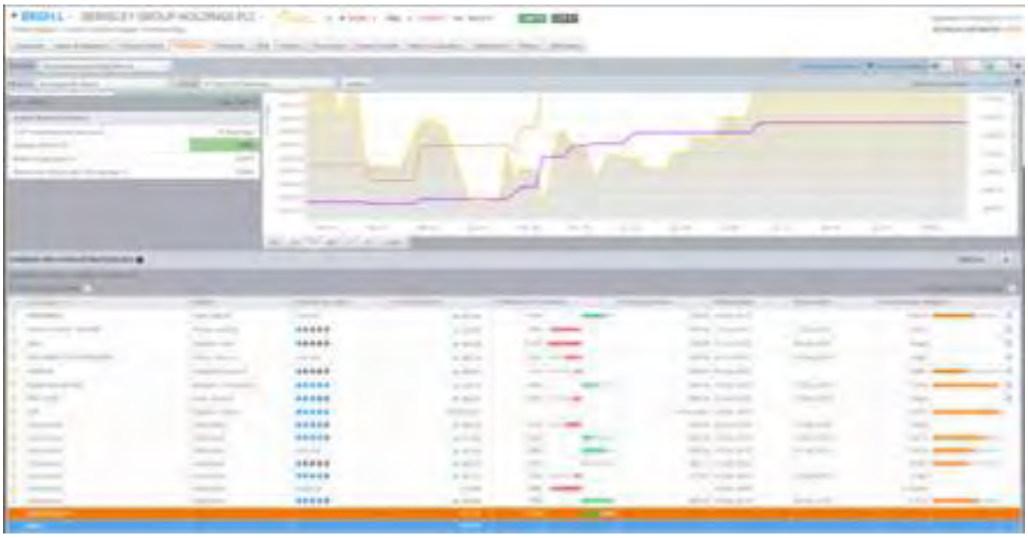
Still plenty of companies with absolutely no research

Of course, there are many companies with no research at all. In fact, 893 LSE-listed stocks had no coverage as at 31 December 2018.

An example of hidden forecasts

To accurately gauge the problem of the 'hidden forecast' we should survey institutions. We can't do that. As a proxy we can look at Hardman & Co's own position. We subscribe to Thomson Reuters and, like institutions, every company has a page for estimates.

Figure 2: Berkeley Group Holdings forecasts



Source: Thomson Reuters Eikon

Here is a typical snapshot. Some brokers are anonymous, either because of the mistaken notion that they would be in breach of MiFID II or to monetise research. Institutions will typically see less, with data restricted to the brokers they pay for.

This demonstrates that, whilst Berkeley management may think fifteen brokers cover them, if Hardman & Co were an institution, the effective number is seven.

The scale of the problem of hidden forecasts

We have used this approach for the whole of the market. At 31 December 2018, our dataset comprises 1,029 companies with at least one forecast.

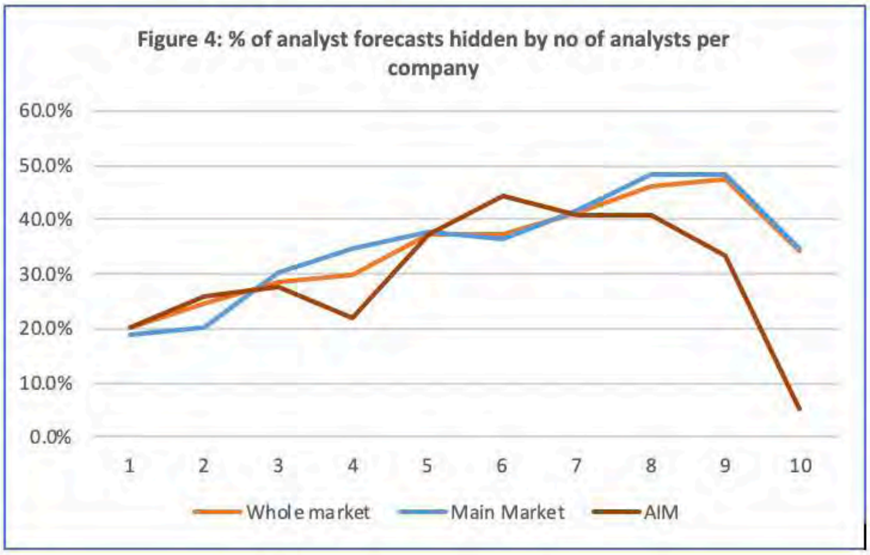
Figure 3: LSE quoted companies by listing with visible analyst coverage at December 2018

Number of analysts	Weighted average of visible estimates				
	Whole market	Main Market	No. of companies	AIM	No. of companies
1	0.80	0.81	37	0.80	261
2	1.51	1.59	32	1.48	120
3	2.14	2.10	42	2.18	62
4	2.80	2.61	51	3.13	31
5	3.13	3.12	34	3.14	21
6	3.75	3.81	42	3.33	6
7	4.10	4.09	23	4.14	7
8	4.31	4.14	21	4.75	8
9	4.74	4.67	18	6.00	1
10+	6.59	6.53	208	9.50	4

Source: Thomson Reuters, Hardman & Co

Note: List excludes investment companies

Figure 3 shows that for the typical company with eight analysts, on average only 4.31 forecasts are shown in full.



Source: Thomson Reuters, Hardman & Co

Figure 4 shows that the more analysts that follow a company, the greater the percentage of forecasts that are hidden. Some caution should be applied to the figure for 10 analysts, since this includes companies with 10+ followers.

The conclusion is clear. Managements who are comforted by a reasonable number of analysts covering them are misleading themselves. The reality for institutional investors is much smaller, often by 50%.

Letter to the Editor

From Mr Allan Gould, Settle, North Yorkshire

I write further to Roy Colbran's article on IHT simplification (TPI 197, page 11) and subsequent discussions with him on that matter.

I know that UKSA are generally not in favour of stockbroker nominees, which is a view that I agree with. However, I would like to relate one area where a nominee might have a benefit (and has had a benefit for me), which is elderly parents. I persuaded my mother (against her better judgement, in her view) to put her shareholdings into the broker's nominee about four years before she died (I ended up being her sole executor).

She had about 25 shareholdings, all certificated. She was finding the admin/paperwork burdensome so there were some immediate benefits (but she wouldn't admit to that!). She and I did all the work chasing down share certificates to move into the nominee, which were either buried in the mists of time or in different desks and drawers. It was much easier with two of us: her memory and my energy. A couple of years later, she moved house: no hassle with contacting all the registrars for change of address, just contacted one stockbroker. When she died, I was sole executor, and it was much easier dealing with all her shareholdings (or rather, I didn't have the stereotypic hassle of finding all the share certificates at a time when I was having to deal with plenty of other things). Also, the broker would have been happy to offer some basic advice and dealing before probate because the shares were in the nominee (subject to some form filling) and not in the deceased's name and he knew I was executor. When it came to distributing the estate after grant of probate, it was simply a case of the broker splitting 50:50 the deceased's holdings from my mother's former account into two accounts already held for myself and my sister (the two beneficiaries): done overnight: couldn't have been simpler.

The Yield Curve - what is it and why is inversion seen as important?

by Rob McDonald

On Friday 22 March 2019, the yield on the three-month Treasury bill[1] surpassed the yield of the 10-year Treasury note for the first time since 2007. It spooked global equity markets enough to trigger a sharp sell-off of stocks with the FTSE 100 dropping 2% the same day, and a further drop when the markets opened on the Monday. The reason given for this was because an inversion in the yield curve is traditionally seen as a signal that investors have become fearful about a future recession. But why is that and is it always true?

From past discussions with some members about the yield curve, I am aware that this latest turn of events has aroused some interest hence I thought this article would be timely.

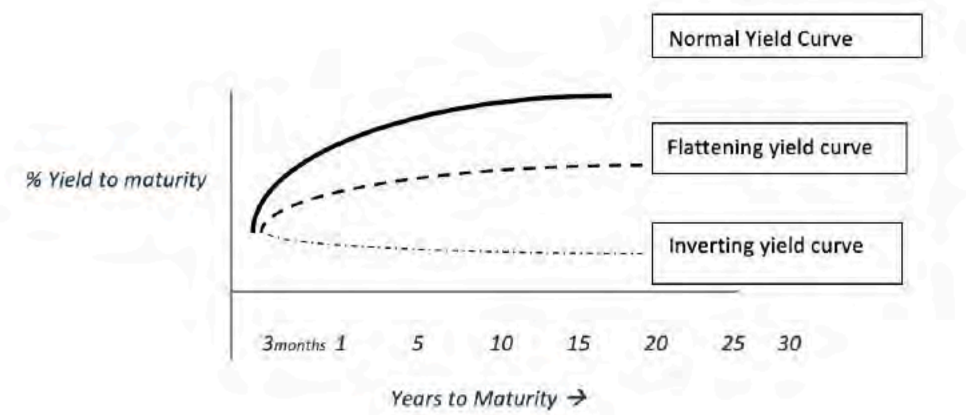
I will begin with the caveat that none of this should be construed as financial advice and my own belief is that it is virtually impossible to time the market to any degree of accuracy.

I first became interested in the yield curve in my role as a Trustee Director seconded to a sub-committee to oversee periodic actuarial valuations of a mature final salary FTSE 100 company pension scheme. (Bond yields play a pivotal role in determining pension scheme valuations, because of the need for the certainty of future cash flows to match pension liabilities, which bonds can fulfil but dividends from equities cannot.)

So what is the Yield Curve?

In simple terms, the yield curve is a chart of the yield-to-maturity[2] of a range of government bonds of similar type, but varying lengths to maturity. Although the yield curve can apply to many debt instruments, possibly of most interest to the UK investor is the yield curve for US treasuries and UK government gilts. Because of the enormous influence of the US stock market on other global equity markets, the former is probably more significant to UK blue chip investors because of the strong correlation of the FTSE100 with US markets.

A yield curve in normal times (I'm defining 'normal' here as a stable and growing economy) would slope upwards as in the following example denoted by the bold line. (Please note that this is a simplified version for illustrative purposes only. They can sometimes have humps and dips along the curve for technical reasons.)



- It should be noted that movements in the yield are inversely proportional to the market price. Higher demand for a bond drives up the market price and results in a decrease in the yield and vice versa. Market commentators will frequently refer to falling bond prices as 'an increase in the yield'.

Unsurprisingly, in normal times investors will seek a higher yield for tying up money in a long-term bond than for a short-term bond, to reflect the increased level of uncertainty of future interest rate movements and the outlook for inflation.

In a booming economy central banks, cautious of the economy overheating with consequential inflationary pressures, may wish to dampen consumer demand by increasing interest rates. Bond investors in anticipation of central bank intentions are likely to resist locking into long-term yields that may increase in the future (i.e. a fall in bond prices) and fail to exceed inflation. Investors in a thriving economy may also have an increased appetite for the risk of equities over bonds. Like most financial markets, the price of a bond will settle once the supply and demand dynamics are in equilibrium. The outflow of capital from bonds to equities will result in rising bond yields and the yield curve will steepen and slope upwards.

This type of environment is conducive to improved bank profitability, as their business lending model depends on borrowing at short-term lower interest rates and lending for longer terms at higher interest rates (often referred to as a 'carry trade', exploiting interest rate differentials in different markets).

When the growth outlook looks less optimistic, however, the following usually occurs:

- Central banks will feel less compelled to put up future interest rates and may well signal their intention in advance. (The Federal Reserve have already indicated that that there will be probably no further rate hikes for the rest of 2019.)

- Bond investors become less fearful of locking into long-term bond yields and the demand for bonds increases.

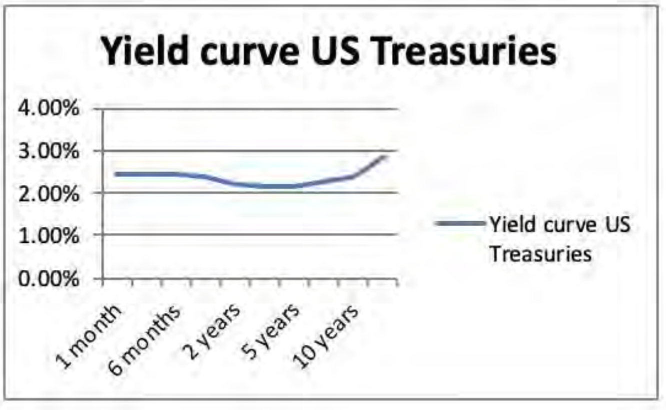
- Risk-averse equity investors, anxious about a possible future economic slowdown, and a stock market fall, rebalance their portfolios in favour of risk reduction, i.e. a flow of capital from equities to bonds begins.

- The combination of the above and other attendant market dynamics results in driving bond yields lower. (and conversely bond prices higher)

The above manifests itself in a flattening yield curve which has been happening throughout 2018 with much accompanying market commentary. Equity investors will view a flattening yield curve with concerns about the economic outlook and it will negatively affect stock market sentiment as indeed we saw in 2018.

It is when the yield curve inverts[3] that stock markets become spooked. If investors are prepared collectively to lock into the lower yields of long-terms bonds, in preference to the higher yields of short-term bonds, the equity market rightly takes notice.

The inversion is interpreted by many as a strong signal of a looming recession and economic stagnation on the horizon. It is easy to understand why, when you consider that over the last 50 years two-thirds of all US recessions have been preceded by a yield curve inversion, including all of the last seven US recessions. The timing of those recessions was anything from 10 months to three years after the inversion. At the time of writing the US yield curve looks like this:



The inversion is clearly visible. A scan through the financial press and listening to the talking heads on the business channels will confirm that there is little consensus amongst the experts on the reliability of this signal as a portent of a recession. I'm not an expert so I will not opine on the reliability.

Is it different this time?

‘This time it is different’ seems to be a common explanation and I have heard that phrase before. Certainly what needs to be borne in mind is that the actions of central banks in terms of their Q.E. programmes in the last decade are without precedent.

Printing of money by central banks in order to purchase their nation’s own long-term sovereign and corporate debt was equivalent to introducing a new major participant into the bond market, one that did not behave rationally like most other participants[4].

This participant was not interested in the normal investment attractions of government debt, but had one underlying aim, to drive down the long-term cost of borrowing in order to stimulate the economy.

Virtually all of the Q.E. purchases were long-term securities. The net result of this would seem to be a flatter yield curve than would have been expected before the financial crisis. Indeed the Federal Reserve’s ‘Operation Twist’[5] exercise of 2011/12 seem to have as its main objective a flatter yield curve.

Whilst Q.E. is now generally on hold, or even on a slow unwind in the U.S., the assets purchased continue to reside largely on the balance sheets of the central banks. (25% approximately of UK government debt is now owned by the Bank of England - Yes! we own this much of our own debt. I will let you ponder that one!)

I do wonder even without further Q.E. whether withholding such a large slice of the supply of long-term bonds from the market continues to keep long-term yields low. I am in good company, as the former chair of Federal Reserve Janet Yellen says: ‘In contrast to the past, the tendency of the curve now is to be much flatter and therefore easier to invert. I don’t see it as a signal of a recession.'

Make of that what you will, but if the financial market believes in the signal it may well be a self-fulfilling prophecy!

Finally I will reiterate I am far from being an expert, but it may be worth keeping an eye on the yield spread between three-month and 10-year treasuries and form your own conclusion.

Footnotes

[1]

US Treasury Notes are similar to UK Gilts. Government-issued debt to finance government fiscal deficit. When US Treasuries have only three months or less of life to maturity they are referred to as ‘Treasury Bills’. These government debt instruments, once issued, pay a fixed sum or coupon for the life of the bond irrespective of the price in the post-issue market.

[2]

The yield to maturity of a conventional bond is the calculated yield once any gains or losses that may be incurred at redemption are factored in. Such gains or losses at redemption arise from differences in current market price and the redemption price. All references here to yield mean the yield to maturity.

[3]

A yield curve inversion is defined technically as when the yield on a three-month Treasury bond (a Bill!) exceeds the yield on a 10-year Treasury bond.

[4]

This is debatable. Other sovereign nations may enter the US and UK government bond markets simply to have a reserve of a foreign currency in order to support their own currency in difficult times.

[5]

Operation Twist was the name given to the Federal Reserve’s operation of selling short-term Treasuries and using the proceeds to buy longer-term Treasuries. It did not require printing of new money and the net effect was to drive short-term yields up and long-term yields down.

CURRENT UKSA EVENTS

A photo ID is requested. Please bring it with you!

Shareholder meeting with BP plc – Wednesday 1 May 2019

Location	**1 St James's Square, London SW1Y 4PD**
Start	**11.30 (assemble from 11.00)**
Room capacity	**50**
Company contact	**Helge Lund, Chairman, and Craig Marshall, Group Head of Investor Relations**
Group leader / UKSA organiser	**Nick Steiner - n.steiner@btinternet.com**

Shareholder meeting with RWS Holdings plc – Wednesday 19 June 2019

Location	**MHP Communications, 6-11 Agar Street, London WC2N 4HN**
Start	**10.30 (assemble from 10.00)**
Room capacity	**30**
Company contact	**Richard Thompson, CEO**
Group leader / UKSA organiser	**Gerald Roberts - gerald.roberts@uksa.org.uk**

Meeting of UKSA Croydon & Purley Group – Tuesday 14 May 2019

Location	**Spread Eagle, High Street, Croydon CRO 1QD** **Starts at 11:30 with coffee from 11:00 Chairman: Harry Braund - harrycb@gmail.com**

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

Branch name	Leader	Administration	Main purpose	Description
London & South East Region	Harry Braund 020 8680 5872 harrycb@ gmail.com	Andrew Girvan 020 8788 1665 agirvan247@btinternet.com	To co-ordinate activities in London and the South-East	Meetings in Croydon three times a year
London company visits	Nick Steiner	Individual meeting organisers	To arrange private meetings with companies	20/30 meetings per year individually arranged
Specialist company visits	Adrian Phillips	Under review	To arrange and/or participate in events in conjunction with investor service companies	Meetings with small-company management, for experienced investors only
Croydon & Purley	Harry Braund 020 8680 5872 harrycb@ gmail.com	Tony Birks 01322 669120 ahbirks@btinternet.com	Social meetings to discuss investment issues	Meetings in Croydon monthly
South West	Peter Wilson 01453 834486 07712 591032	Peter Wilson 01453 834486 07712 591032	To arrange and develop activities for members in the region	Company visits and social events as arranged
North East	Brian Peart 01388 488419	Julian Mole 07870 890973 julian.mole@ btinternet.com	To arrange and develop activities for members in the region	Company visits and social events as arranged
North West	Julian Mole 07870 890973 julian.mole@ btinternet.com	Julian Mole 07870 890973 julian.mole@ btinternet.com	To arrange and develop activities for members in the region	Company visits and social events as arranged
SmartCo	Charles Breese	Charles Breese	Arranging access to 'Smart Companies' – those with the potential to make good investment returns from benefiting society at large	Programme awaiting start-up