Better Finance Workshop 30 November 2021, European Retirement Week: how do I get value for money?

Helping individuals to help each other – the “savers take control” agenda

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Introduction

- These slides will be loaded onto the UKSA web site following the event. Simply google "savers take control"
- The slides are intentionally somewhat repetitive, and I will not talk through them in detail.
- Further material will be prepared depending on the discussion at and following the event
  – Please see https://www.uksa.org.uk/Savers_Take_Control
  – And also check developments at https://www.uksa.org.uk/page/reference-material-betterfinance-conference-slovenia-2021
  – The inaugural full 2017 STC talk, in powerpoint form with speakers notes, can be downloaded from https://www.uksa.org.uk/sites/default/files/2017_NR_Final_Words.ppt
- Martin White, some personal details (small print)
  - Electrical engineering degree, followed by actuarial training. Life insurance (Save and Prosper Group), followed by Pensions consulting (Clay and Partners). After this, in 1988 I became the first actuary employed by the Corporation of Lloyd's of London (this included regulatory experience), and I was involved in the reconstruction of Lloyds and the setting up of Equitas. Active volunteer within the actuarial profession and campaigner in the interests of the individual in the face of the financial sector. Author/co-author of a number of general insurance actuarial research papers. Member of the UK Shareholders Association from its founding in 1992.

Background to today's discussion: the lot of the saver, especially across Europe

- What's the problem: this study tells us more than enough:-
- EC study on the distribution systems of retail investment products: https://ec.europa.eu/info/publications/180425-retail-investment-products-distribution-systems_en
- This study is a shocking read. The situation for individuals is frequently appalling.
- A challenge from Mme Yon-Courtin : "In your view, what concrete idea would be the silver bullet for consumers to unlock the power of their savings?"

- Today, the financial sector is in a profitable position of power. The consequence for individuals trying to make financial provision for the future is not good. And, given the challenges involved, many people do not engage with the problem – "It's all too difficult, and who can we trust to act in our interests?" The answer, sadly is "almost nobody"

Some things to note (caveat)

1. The motivation of the presentation is to share ideas and stimulate discussion, in the hope that our collective understanding will improve, and perhaps also that others will be interested to help develop ideas and initiatives for a grass-roots approach to tackling the problems.
2. *Nothing in this presentation or talk should be interpreted as financial advice.*

3. Generalised criticism of all sorts of groups is no more than that – whilst the business environment can cause people to act in a way that attracts criticism, there are always exceptional people who behave well. For example company boards who are not greedy and who steward the business well, in spite of short term pressures from "shareholders".

4. All the content represents the <u>current</u> views and understanding of the presenter alone, and does not represent the views of any organisation with which I may be associated. *But UKSA endorses the analysis in general and enthusiastically supports this initiative.* If you believe the suggestions here have value, and would like to help develop them in any way, you should join us!

Wider problem: corrupted ownership chain

- Individuals are still the main beneficial owners of companies, but often through a big chain of wealth-extracting intermediation, or hidden behind nominees.
- Individuals do not have any body they can trust to tell them the fundamental truths of finance and investing – because everyone is on the take!
- Read John Kay’s books “The long and the short of it” and “Other people’s money” if you want to really understand all this.
- IFAs - want to take annual percentage of wealth, but if wealth too small, they don’t want you.
- Fund managers – also take an annual percentage, which isn’t really worth paying, unless it’s a super-cheap passive
- Fund managers – individuals get paid for “asset gathering”, so have a short term perspective. Pay at fund managers is high– see the UK FCA Asset Management study.
- “Platforms” think they have a right to an annual percentage of your wealth if you put your money in “funds”. So they promote funds like mad.
- But all the “education” material downplays the importance of expenses, and how to minimise them.
- The consequence of all this is that most company stock is in the name of the fund managers - who have no incentive to ensure companies are run patiently and not greedily. This has bad consequences for almost everyone.

Tackling the conflicts and the power of the financial sector

- Today, the financial sector frequently acts as if it has a right to take an annual percentage of your wealth.   You have to avoid this –but how? And who is going to tell you the truth?
- To start to tackle the problem:
  - There needs to be a “who to trust” body, or network of connected bodies across countries, made up of non-conflicted knowledgeable volunteers. It is vital that representatives of the financial sector are kept out of these bodies, but it is also vital that the volunteers are knowledgeable.   The role of these bodies has to be each of education, advocacy, and organisation.
  - The ability of these bodies to speak up without fear of reprisal needs to be protected by politicians.
  - Financial service regulators should all have a majority of consumer representatives on their governing boards. Currently, financial regulators often point out the vital truths, but do not have the appetite to broadcast to the public interest how to identify and access the best value products for themselves
  - Where are these volunteers to come from?   I believe that the retired population holds the answer. Plenty of people retire from the financial sector, including from my profession, actuaries, wanting to “give back” to society and the next generation.

Tackling the corrupted ownership chain

- Today, individuals are mostly powerless
  - They lack knowledge, they lack confidence in their ability and intelligence, and the message from the financial sector is “trust us”
  - Sensibly, most people no longer trust the financial sector. But negative emotions lead to “do nothing”, so this is one reason for not enough saving.
  - The information asymmetry versus the industry leads to massive wealth extraction
  - The media probably do more harm than good, with over-focus on capital gains; what are people to think? That the stock market is for gambling in.

- But what if individuals were told the essential truths (see next slide for suggestions), and helped / empowered to act accordingly?
  - The power would no longer be with the financial sector, it would be with the customers
- But how could we get to a situation where individuals were told the essential truths (when we have agreed what they are)?

Some essential truths about finance and investment (not the last word, just some ideas)

- Anyone who buys and is capable of working through the John Kay's books "The Long and the Short of it" and "Other People's Money" will understand the issues well enough
  - How wealth is created over time in companies is a long term process, needing a focus on future competitiveness as much as on profits today.
  - And it's fundamentally uncertain, uncertainty you have to live with
  - That market values fluctuate massively over time; you have to use "tricks" and "habits" to avoid making emotion-driven "buy high, sell low" mistakes.
  - One "trick" is to think of your equity investments as things that will generate a (not too certain) future dividend flow.
  - Minimise annual percentage charges above everything – work with other investors to minimise the intermediary take. Mutuals, such as Vanguard are good for this, but a mutually owned stockbroker is perfectly possible too.
  - Understand that pooled funds are no more than a spreading of risks across individual companies; they cannot transform the fundamental nature of share ownership
  - Understand your own needs in terms of financial planning
- But people will still need there to be someone to help them put the principles into action – this is the missing "who to trust" body
- That body is only going to exist and thrive if enough of those with the knowledge work together for free to develop a solution with the objective of helping everyone, not just the rich.

But those "essential truths" are so foreign to most people – where on earth do we start?

- How easy are those "essential truths" going to be to assimilate?
- How often do you hear "the solution is better financial education in schools"?   But I'm suggesting that just schools is not enough
- Who might come forward to develop financial education material?
  - Yes, the financial sector!
  - We can't have that – that's the entire point! We need individuals to be the masters, not the financial sector as is the effective situation today.
- So it's got to be done by people with the knowledge and passion to transform that situation and empower savers – a nationwide project.
  - It will only take a relatively small number of people to get it going; probably with one thing in common – they'll all be savers
  - UKSA's working title for this idea is STC, standing for "savers take control". Hence the email STC@uksa.org.uk
- STC: a completely new idea – virgin territory!
  - Involves highly knowledgeable investors giving up their time to help others – what could be more worthwhile? Or more potentially transformative?
  - Hugely challenging
  - But also huge fun and very rewarding – anyone interested?

Some themes and references for the pensions discussion: 1 of 2

- Deep conflicts, and failures, including regulatory failures
  - The Neil Woodford story in the UK is a powerful wake-up call. I have recently finished “Built on a Lie” by Owen Walker, which is an easy, but disturbing, read.
- Facing up to uncertainty – vital, but frequently just ducked
  - For example, I believe that future real investment returns on equity portfolios, before expenses, in the decades ahead, are likely to be extremely low. Why? In a world that adapts properly to avoid climate change and protects biodiversity, there may be very low levels of economic growth. Therefore, after expenses real returns could even be negative. This means it is vital to minimise expenses – which means the financial sector must shrink significantly.
  - I was a co-author of a paper on principles for improved decision making under uncertainty: https://www.actuaries.org.uk/system/files/field/document/MUWP%20paper%20Feb%202019%20Final_X3.pdf
  - John Kay and Mervyn King have written a superb book on Radical Uncertainty: see https://www.johnkay.com/?s=radical+uncertainty
  - There is a strong cautionary message for actuaries around financial assumptions relating to pensions in Warren Buffett’s famous 1977 Washington Post pensions memorandum. This memo can be found at the end of the annual report at https://www.berkshirehathaway.com/2013ar/2013ar.pdf The pensions memo starts at the page numbered 118 in the report. The world was very different in 1977, but the relevance to today of the entire pensions memo is startling.

Some themes and references for the pensions discussion: 2 of 2

- Expenses – and value added, or not, by fund management
  - Huge congratulations for Better Finance for its Real Return study
  - The Buffett Washington Post paper tells the key truths here. In aggregate, active management destroys value. All research confirms this, and it makes complete sense that it should be so. The sensible thing is to avoid significant annual percentage charges. Yet the fund management sector makes high profits and pays high salaries, a bit of a puzzle perhaps.
  - The impact of expenses in the fund management process is greater than just the explicit charges – there are so many other costs suffered by the fund, including the impact of trading costs
  - Over an investment lifetime, including during retirement, a 2% annual decrement in returns will lead to roughly a 50% reduction in ultimate outcome. Is it possible for some people to reduce their total expenses by 2% per annum? I would definitely say yes. This would double the outcome. For them, today, the financial sector takes half their ultimate outcome.
  - I have written an article discussing an "intelligent" contract between customer and active fund manager. I call this the "active management partnership". The key point is that the deal is much less one-sided than the conventional arrangements. See https://www.uksa.org.uk/sites/default/files/2021-07/Active-Management-Partnership-LongTermSolution.pdf