ShareSoc

UK Individual Shareholders Society

PO Box 62, Chislehurst, BR7 5YB
Phone: 0333-200-1595
Email: info@sharesoc.org
Web: www.sharesoc.org

22 September 2011

The ShareSoc Manifesto

One of the key ways we can help shareholders is to promote a simple "manifesto" that encapsulates what we stand for. This document explains the policies which ShareSoc (The UK Individual Shareholders Society) advocates. Many of the policies require action by the Government or legislation to support them, or action by other financial market supervisory bodies. We feel our proposals are beneficial to the general health of the UK stock markets and of UK business, and to their leading place in the world financial and business community.

Our manifesto will form the foundation for more detailed policy development in the future.

Note that this is not just a manifesto for individual shareholders, but for all shareholders (i.e. including institutional holders) as the proposals are aimed to benefit all stakeholders in public companies. Many of the proposals support stronger "shareholder engagement" with companies as has been recommendation by others.

We hope that you will read this document and support the policies defined therein. Comments are welcomed and if you wish to help to promote these policies please contact me.

Yours sincerely

Roger W. Lawson
Director

The Manifesto

The following is a summary of the main points which are explained more fully later in this document:

- **The oversight of companies should be restored to their owners.**
- **Shareholder democracy should be improved and shareholder rights strengthened.**
- **The legal framework for companies should be changed to improve accountability.**
- **The taxation of investment profits should be reformed to make it more equitable and reduce complexity.**
- **Excessive director pay needs to be restrained.**
- **Direct share ownership should be encouraged.**
- **Investment education needs to be improved.**
- **Information flow to shareholders should be improved, with all shareholders receiving the same information.**
- **Insolvency law should be reformed.**
- **Stock market regulation and enforcement should be improved, especially for the AIM Market.**

Why these policies are needed

Investing directly in the UK stock market can be financially very rewarding, in comparison say with investing in cash deposits at low interest rates, in fixed interest bonds which are vulnerable to inflation or via collective funds where high charges often apply. But many investors will be well aware of the problems that are presently associated with such investments.

Even though the Combined Code on Corporate Governance, the revised Companies Act, and the UK Stewardship Code have improved matters in some areas, there are still many areas of concern. To highlight some of these:

1. The directors of companies still often pay little attention to the owners of their companies – who are of course the shareholders. For example, consider the case of the Royal Bank of Scotland (RBS) and the takeover of ABN-AMRO. This was strongly opposed by a number of their major institutional shareholders but their views were ignored by the directors who presumably thought they knew better and who proceeded to push it through. The resulting debacle where RBS almost ran out of cash and had to be bailed out by the Government resulted in a massive erosion of shareholder value. This could have been avoided. Similar but less publicised events take place on a daily basis in smaller listed companies. Shareholder "engagement" is never going to be effective while shareholders can be ignored by boards of directors.

2. Incompetent management still takes too long to remove, and the role of "independent directors" on boards is not strong enough to stop companies being dominated by forceful chief executives or chairmen. Part of the problem of course is that both independent directors and executive directors are appointed by the existing directors (in practice co-opted or nominated for uncontested elections). Although the day-to-day management of companies should clearly be the domain of the appointed directors, the owners of companies should be consulted about major strategic decisions and their views taken into account.

3. Likewise the pay of directors is determined by the same directors, so directors effectively set their own pay. The fact that pay levels are nominally set by separate committees of the board does not in practice make a lot of difference. The use of independent consultants and comparisons with other companies has also led to a constant ratcheting up of pay levels so the pay of many public company directors has grown much faster than company profits in the last few years, and much faster than the pay of other staff. It is now reaching obscene levels in companies such as banks such that it is now morally very questionable. In addition, even in some small companies, it is now diverting a substantial proportion of company profits from shareholders. There is a general consensus that pay levels need to be restrained, but there seems to be no mechanism in place to do so and total remuneration continues to rise (the introduction of remuneration report resolutions has had little impact).

4. Apart from the problem of incompetent management, directors in smaller companies (such as AIM stocks) often seem to be "ethically challenged", and if they do not actually break the law they may well mislead shareholders about the affairs of their companies, sell shares at opportune times based on inside information, issue large numbers of shares, options or warrants that are in their interest but not shareholders and prejudice minority shareholders by doing placings to their favoured institutions (or to themselves).

5. Regulations are ineffective in controlling such activity, and even when the law is broken, they are unlikely to be pursued. The law and market regulations are too weak and the regulators are not forceful enough and are under-resourced to pursue many of the issues that arise.

6. Indeed even if shareholders wish to pursue an issue in law, they have little ability to do so because shareholders have no contract with the directors and there is no concept of "fraud on the market" in UK law. Actions for "breach of duty" by directors are generally impractical. Even if actions are practical, the costs of litigation are now so high that only the wealthiest institutions could risk an action against a public company, and most fund managers have no incentive to pursue such claims. Similarly, if the financial accounts of a company have been misleading to shareholders due to failures by the company auditors, the shareholders have no claims that can be pursued in law and more and more obstructions to possible claims against auditors have been put in place over the last few years. Likewise other professionals involved in promoting or regulating companies (brokers, AIM Nomads, etc) are ever more protected from their own failings.

7. In essence the legal system which acts as the framework for companies has been watered down in the interests of company directors and their professional advisors over the last 50 years, to the detriment of shareholders interests.

8. One solution to some of these problems (although not to all) would be to have strong shareholder democracy where shareholders could easily change matters if they saw it necessary. But the migration of most shareholders into nominee accounts has effectively destroyed this. One can no longer easily communicate with your fellow shareholders, or indeed know who they are. Shareholders in nominee accounts have difficulty voting and receiving corporate information, and most private shareholders are in practice disenfranchised totally (the last Companies Act did not significantly change this).

9. A General Meeting of a company is no longer viewed as the forum where directors report on their stewardship of the company and are questioned by shareholders. It has become an archaic format where most shareholders (including almost all institutional holders) stay away. It needs significant reform.

10. One reason that General Meetings are not attended is because institutions have their own private briefings from the directors (e.g. at results presentations or later analysts meetings). The City of London is still not an "open" forum where all shareholders are treated equally and any information made available is put into the public domain. It still operates in some ways as a private club of insiders where who you know is more important than your rights as a shareholder to be treated fairly (and this can be as disadvantageous to some institutions as it is to private shareholders).

11. Because of the fragmentation of shareholder ownership in the last few years (many more investment funds, with more of the UK market held by foreign institutions), this has strengthened the hand of directors in comparison with their shareholders. With directors having control over the information flows and institutions finding it difficult to co-ordinate action, the result is ineffective control of errant boards. In addition the growth of tracker funds and ETFs who have little interest in "engagement" has also undermined shareholder democracy and longer term investment policy. Indeed many shareholders are now simply treating the stock market as a casino where they buy and sell financial instruments rather than accept that they own a small slice of a company with a responsibility to follow and control its affairs.

12. Even the Government has encouraged this mentality by not recognising shareholders as owners of companies with the associated rights and many politicians see shareholders simply as speculators – consider the Government's statements at the time of the nationalisations of Northern Rock and Bradford & Bingley if you do not believe that.

13. Retail investors are generally ill informed about the stock market and about investment, with the result that they are often misled into investing in funds with high charges, and with inadequate diversification in their portfolios. The financial institutions tend to promote their own interests at the expense of sensible investment and saving for retirement. As a result, people do not save enough or choose poor investments (often "indirect" ones with high charges). The increasing distance between investors and the companies they own due to the growth of indirect investment means that a large proportion of the financial returns generated by companies ends up in the pockets of financial sector operators (brokers, fund managers, you name them) rather than the investors.

To summarise, shareholders have lost control of the companies they own, and regulation has been ineffective in preserving the rights originally envisaged when limited companies were first formed. These are not trivial issues that simply affect a few shareholders in any one company. The whole global banking sector was almost destroyed by a combination of imprudent directors and poor regulation, with a devastating impact on the economy of many nations which has affected the wealth of the general population in recent years.

The failure of investors (particularly retail investors) to understand what is happening in the companies they own, and their distancing from direct control has resulted in the failure to oversee the boards of companies because the "agents" who act as the intermediaries between investors and companies have no proprietary interest in doing so.

More explanation of the proposed policies

1. **The oversight of companies should be restored to their owners.** Control should be restored to the shareholders of companies. Directors should be both selected and appointed by shareholders via the use of committees consisting primarily of shareholders to put forward appointees on which a vote is taken at a general meeting of the company. Our specific solution to this problem is the establishment of "Shareholder Committees" on which we have published a 17-page note that explains why they are needed and how they would operate – available from this page of our web site: www.sharesoc.org/policies.html (see bottom right of that page).

2. **Shareholder democracy should be improved.** Real shareholder democracy should be restored by ensuring that all shareholders (including those in nominee accounts) have the right to vote, to attend general meetings and receive information on the affairs of their company. In addition anyone else who wishes to communicate to all shareholders on the affairs of the company should be able to do so at low cost (via electronic communication if available), subject to the existing "proper purpose" rule. Our proposal in this area is quite simple – namely that we need a proper system to ensure that all beneficial owners who hold their shares in nominee accounts are treated in the same way as those on the share register. Indeed they should be on the share register with the ability to opt out of company or third party communications if they wish. Such an option should only be granted if they have read specific wording to advise them of the loss of their normal legal rights and an explanation of the disadvantages of doing so. The systems operated by share registrars already provide for the use of such "designated nominee" accounts as opposed to the "pooled nominee" accounts used by most stockbrokers (which is for their convenience and not to the benefit of shareholders).

3. **The legal framework for companies should be changed to improve accountability.** Directors and auditors should have a duty to, and be legally accountable to shareholders. The legal concept of "fraud against shareholders" should be introduced in a new law to cover such matters as issuing false or misleading information to the market or the prejudicing of minority shareholders, and provide a basis for legal actions. And the legal system should be reformed so that shareholders can pursue grievances at reasonable cost. In addition the penalties for fraud should be increased.

4. **The taxation of investment profits should be reformed to make it more equitable and reduce complexity.** At present, the taxation of capital gains and dividends is complex and yet inconsistent in many areas. Tax free schemes such as ISAs allow some AIM stocks to be included but not others, even though SIPPS generally permit them. In addition shareholders are paying capital gains tax on gains that have arisen simply from inflation rather than real gains. Also a simpler system to encourage tax free savings, investment in early stage companies and longer term holdings (as opposed to short term speculation) should be introduced.

5. **Excessive pay of directors needs restraining.** The pay of directors and senior managers in some companies has become excessive and should be controlled by ensuring that shareholders both set and approve board pay in advance (via a Shareholder Committee and vote in general meeting) and not by solely allowing the directors to determine their own pay with retrospective approval by shareholders. See the note mentioned above for more details on Shareholder Committees.

6. **Direct share ownership should be encouraged.** Direct investment in the stock market should be encouraged by removing the tax advantages and privileges of institutions and collective investment vehicles (without prejudicing past investments and while still encouraging socially useful purposes such as pension provision).

7. **Investment education needs improving.** The education of the public on stock market investment should be improved, and more encouragement given for people to manage their own financial affairs in a low cost manner.

8. **Information flow to shareholders should be improved, and a level playing field ensured.** The restricted disclosure and the dissemination of "inside information" should be stopped by the introduction of the equivalent of US Regulation FD, so that there is a level playing field for all investors. All presentations by management should be open to all investors, with no closed meetings for analysts alone.

   The primacy of the company General Meeting should be restored by using electronic communication more (video or audio web casts for example). Annual Reports should be improved by the provision of key summary information in a standard format.

9. **Insolvency law should be reformed**. Insolvency law should be changed to prohibit "pre-pack" administrations which often prejudice minority shareholders, and competitors of the company which is in difficulties while enabling "phoenix" companies to arise with the same former directors and controlling owners. Administration should provide more means for a company to trade out of its difficulties and avoid a sale or insolvency process, leaving nothing for shareholders while large fees are paid to the administrators or liquidators, as happens at present.

10. **Stock market regulation and enforcement should be improved, especially for the AIM Market.** The regulation of the AIM market should be improved so as to ensure proper oversight of companies and that inappropriate companies do not join the market. Liquidity is insufficient in many such companies and too many de-list or get info financial difficulties. Current trading mechanisms can actively discourage liquidity by imposing wide spreads on buyers and sellers. Stricter enforcement and harsher penalties need to be imposed on advisers who are supposed to ensure compliance with standards of behaviour which investors are entitled to expect, such as honesty in shareholder communications. Tougher penalties should also be imposed on any directors responsible for misleading communications.