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A joint submission on behalf of Private Investors from ShareSoc and UKSA

5 February 2018

Chris Shaw,
Clerk,
BEIS Committee on Corporate Governance

Dear Chris,

Carillion and implications

Please note this is a joint response on behalf of UKSA and ShareSoc

We understand that the Select Committee, along with the Work and Pensions Committee, is looking at the collapse of Carillion at the moment. So, we are submitting our views on this; and in particular our comments about shareholder engagement in respect of Carillion.

Carillion

1. The Carillion collapse was entirely predictable to experienced private investors. As were the reasons for it. Perhaps that's why special interests have ensured that we are excluded from consultations and denied **voting rights**?
2. UKSA's members' magazine, 'The Private Investor', highlighted accounting, reporting and audit failures in **September**, updated the story in **November** and summarised the sad consequences in **January**.
3. Carillion, the Government and the regulators are ignoring the knowledge and experience that private investors would bring to counteract special interests. Private shareholders were initially excluded from the 'Stakeholder Panel' set up in response to the Green paper on corporate governance reform until we complained. Recent regulations on KID (Key Information Document) also illustrate departures from common sense which private investors would have immediately spotted, see **UKSA news**. UKSA-ShareSoc continues to fight for representation on consultative and regulatory issues until such time as corporate governance deficiencies are corrected (see **UKSA's response** to Green Paper).
4. Conflicts of interest are worth mentioning. Our understanding is that Standard Life, for example, held a lot of Carillion shares on a long basis for some of their funds and were also 'lending' them to short sellers.
5. It seems likely that the Carillion collapse will deliver hard lessons about both the effectiveness of audit, the relevance of the Annual Report and the fitness for purpose of current accounting standards. It is important these lessons lead to action. We await the promised report from the FRC.

Carillion and Engagement

The problems of engagement at Carillion seem similar to the problems we generally observe:

6. Engagement is failing. There are a number of reasons for this:
    a. The informal nature of current shareholder engagement (cosy chats with selected shareholders behind closed doors) does not work well for the broad shareholder base. It is not clear whether investors are each being told the same story, how information is being spun, or whether complete or only partial information is being given out. Investors will ask different questions during engagement meetings and so may develop different interpretations of what the company is trying to achieve.
    b. Ad hoc engagements tend to only occur when a problem arises.
    c. Currently, when a large number of investors are "consulted", it is difficult to have the same conversation with each investor and the proposal often changes over the process of engagement. Currently, the different views of different investors create a very "messy" backcloth in which to engage.
    d. For example, in relation to remuneration proposals, there is often no clear trail from the initial proposal though to the final version voted on by shareholders.
    e. Voting happens too late in the process. Discussion and voting at the AGM is ineffective, as institutions do not like to vote against the directors' recommendations. A more professional and systematic process is required.
    f. This impasse can be broken through the introduction of Shareholder Committees, the key benefits being:

    i. Systematic briefings between the company and knowledgeable Shareholder Committee Members.
    ii. Shareholder Committee Members will develop good background knowledge, relationships and trust with the company over time.
    iii. Shareholder Committee Members will be presented with consistent information and explanations, and members will have a forum for the exchange of questions and views.
g. Another useful initiative would be the introduction of Shareholder Meetings with individual shareholders, when the company presents on progress and shareholders can ask questions on strategy, cash flow, accounting and other issues.
h. Another useful idea which we are pursuing, with the help and support of PWC, is meetings between the Chair of the Audit Committee and investors.

Generic Problems

The following generic problems impact and help cause problems such as Carillion.

7. The UK has a problem: “Ownerless corporations" that result from fund managers' commercial interests generally not supporting engagement with their investee companies. This problem has been identified by many (e.g. Lord Myners, Prof Kay), but not resolved. New approaches are needed.
8. Active fund managers need more focussed portfolios. (This was a Kay Review recommendation). There are too many companies in too many portfolios. This makes it difficult for the fund managers to properly engage with the companies as they do not have the resources (i.e. they choose not to have the resources). Very few fund managers attend AGMs and so miss a key opportunity to meet and talk to any and all of the directors. Their stated reason is that they do not have the time (i.e. resources) to do this. (By “Active” I mean those fund managers who are not passives.)
9. Active fund managers have a short term focus:
    a. They are not aligned with the investors who are the ultimate beneficial owners who are usually investing on a 20 to 40-year horizon.
    b. Active fund managers favour volatility. They create a bias for action (another Kay Review conclusion). They are encouraged in this by investment bankers, accountants, lawyers, strategy consultants, investment consultants (who are very influential) and the press. They all fuzz obsessively about volatility. They have encouraged and consistently voted in favour of remuneration systems which reward volatile share performance disproportionately more than steady growth (the many academic studies which show no statistically valid relationship of performance and pay is a supporting fact to our statement).
10. A growing proportion of money is invested in passive funds, who only have small stakes in each company and hence small influence.

11. You should contrast the objectives of the private investor with fund managers. Private investors:
    a. Primarily are investing for the long term
    b. Are investing their own money (not others).

I would be happy to come and talk to you personally or your Committee.

With best regards,

Cliff Weight
Director
ShareSoc