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Labour Party Review of Financial Services

The UK Shareholders Association and the UK Individual Shareholders Society (ShareSoc) are pleased that the Labour Party is taking the initiative with its Review of Financial Services. We are keen to support this initiative by making this submission to the Review Panel and hopefully by being included in subsequent activities. Unfortunately, we have had very little time to prepare this. Consequently it represents a summary of key issues that we believe need to be addressed and, hopefully, provide a starting point for further discussion and dialogue.

The issues covered in this paper have been categorised under your key thematic headings: **capital markets, competitiveness, consumer protection, innovation, and sustainability.**

1. Capital Markets and Competitiveness

Since 2016, many overseas investors have ignored the UK regarding it as supposedly a bad bet, with leadership who are not business savvy nor interested. Brexit is sometimes seen as a message to international investors to ignore the UK. This does however prompt the question as to why has private equity (PE) been seen recently as attracted to UK stocks?

1.1 What is the most significant change you would like to see with FS policy?

- Make the UK an attractive place to allocate capital. Requires a long term policy, not a series of short term stunts. Cohesive, integrated, competitive.
    - Start with root cause analysis to identify the key causes of investment in the UK appearing to be unattractive and develop plans, long term if need be, to mitigate these causes.
    - Trade deals with major economies so UK companies can compete on a level playing field basis – and, in particular, the removal of barriers to trade with the EU, our largest and geographically closest trading partner. The current Trade & Cooperation Agreement is very insufficient.
    - Government budgetary expenditure plans that will underpin the exchange rate, future interest rates and future tax rates. (Note, people will not invest if they think their investments will be eroded by exchange rate losses and high taxes.)
    - Good governance and the ability of shareholders to exercise their rights. The work of the Digitisation Taskforce we refer to later in the Innovation section (3) of this letter has implications in this area.

- Increase valuations of UK companies. The following factors need to be considered:
    - There are no differences between jurisdictions in the ways investors (and therefore markets) value companies. One factor for a company's higher valuation compared to another is the long term demand for its shares as an investment, usually reflected by

its long term viability, resilience, sustainability, profitability, cash generation and attractiveness to consumers of its products and services.
    - It would be helpful to have confirmation that UK tax schemes that stimulate UK investment will continue e.g. SEIS, EIS, VCT and others.
    - As mentioned above, the UK needs to be made an attractive place to allocate capital.
    - Increase financial education of children and the missing generation of their parents and hence increase their interest in investing in the UK stock market. Financial education also has important implications for consumer protection (see section below on Consumer Protection) by enabling consumers to look after their own interests more effectively.

1.2 How can a future Labour government support the reinvigoration of the fintech sector to compete with other jurisdictions?

- Current schemes are largely working well.
- One problem is the lack of unicorns. Our tech companies tend to get taken over rather than grow into unicorns. We need to provide extra support for such companies to make it attractive for them to want to stay in the UK.

1.3 How can a future Labour government support a stronger ecosystem for high growth firms to found, grow, scale, and list companies in the UK?

- See above.
- Destigmatise bankruptcy. One of the factors in the success of Silicon Valley has been that entrepreneurs have been allowed to fail, learn the lessons of their failure and try again.
- Also Labour need to promote success, welcome change, especially the inevitable disruptive technologies and a renewed emphasis on Science Technology Engineering and Mathematics and the crucible of technology (Harold Wilson was right).

1.4 Other important requirements

- Following the collapse of Carillion in 2018 Sir John Kingman carried out a major review of the Financial Reporting Council (FRC). Since then there has been significant reform of the FRC. However, this work remains unfinished. A key part of the transformation plan for the FRC was that it should transition to becoming the Auditing, Reporting and Governance Authority (ARGA) with wider regulatory powers and the teeth to use these powers. The enabling legislation for ARGA to come into being has still not been enacted. This needs to happen as a matter of urgency. It is a vital component in ensuring that investors see London as an attractive place to invest and that companies will continue to see London as an attractive place to list.

2. Consumer Protection

There are two main components of consumer protection:

- Improving consumer financial education so that consumers are better able to look after their own financial interests with confidence; this we believe is by far the most effective component.

- Legal and regulatory systems of protection and redress. These are important but they are also complex and expensive to design, apply and keep up to date.

We discuss each of these in more detail below.

- *Consumer education.* It is vital that consumers should, first and foremost, be able to look after their own financial interests rather than relying on the state to do this for them. The majority of consumers are, however, in no position to do so. Standards of financial education and awareness in Britain are woeful.

  In response to an 'Inquiry into strengthening Financial Education' UKSA and ShareSoc have presented new ideas to address the UK population's weakness in financial literacy. We have responded that this subject above all needs a holistic approach. Currently multiple initiatives representing different interests and opinions are preventing effective progress. We have presented a framework for the future in which teaching in schools could be embedded. The submission is extensively supported by references as evidence.

- *Legal and regulatory systems* to ensure that providers of financial services are required to act in the best interests of their customers (consumers). Systems of compensation for consumers who have lost money as a result of unfair or exploitative behaviour on the part of suppliers form an important back-up to this. However, systems of recompense for consumers (FSCS etc.) are a 'back-stop' and an admission or acceptance that consumers have been failed by the normal protection systems. As mentioned above, much more can be done by improving the financial education of consumers so that they are better able to look after their own interests. This is always going to be much more effective than applying more and more layers of complex regulation which most consumers will not read or understand and will not therefore know the limits of protection and redress they can expect.

  The development and maintenance of regulatory systems of consumer protection are primarily the responsibility of the Financial Conduct Authority (FCA). The FCA has not always performed this task well as was evidenced by the Gloster Report in 2020 following the London Capital and Finance scandal. Numerous other scandals may be provided as evidence. The main issue with financial services regulation is that consumers' interests are not put before providers' interests. The FCA's new consumer duty may help but it is too early to see if this will make any difference. Our perception is that the FCA is, in general, poor at engaging with consumers. It finds it easier to talk to the members of the industry it regulates and is sometimes excessively influenced by lobbying from the industry. Too often little more than lip service is paid to doing what is in the interests of consumers.

  To rebuild trust in the capital markets and in the financial services sector the Government also needs to:

  - Review the way in which the Financial Services Compensation Scheme works, perhaps with the government sharing the funding / levy burden;
  - Review the remit of the FSCS and the boundaries of the regulatory perimeter, perhaps with a view to expanding the perimeter;
  - Revisit the effective ring-fencing and protection of custodied assets;
  - Review (again) the Special Administrations Regime;
  - Accelerate the Financial Ombudsman Service resolution process;

- Accelerate the FCA enforcement process and improve transparency over both the process and the outcomes;
- Revisit the regulatory responsibilities of London Stock Exchange Group over the AIM market.

3. Innovation

One theory is that innovation has been lacking in the UK because companies are no longer spending enough money on it in Research and Development. The innovation deficit may be resolved by also doing a root cause analysis and subsequently developing solutions, similar to the suggestion above for increasing investment in the UK.

We are also mindful that empowering shareholders will help. We strongly believe that this can be achieved in conjunction with the move towards dematerialisation and the work the Digitisation Taskforce is currently doing. Proposals for dematerialising share certificates were started when CREST was introduced in the 1990s. We believe that technology has moved on to such an extent since the 1990s that it should be easily possible for certificated shareholders' rights to be retained by them on dematerialisation of their shares. Importantly, it should also be possible now to restore to the underlying beneficial owners (UBOs), whose shares are held by nominees, the rights that they have had to pass over to the nominee/s. The nominees have no interest in exercising these rights themselves (it is not their money that is at stake) and the return of rights to the UBOs is an important component in restoring effective corporate governance. The proposals in the Interim report of the Digitisation Task Force make insufficient progress in this area.

There is a debate about who should pay for the systems costs to enable shareholder rights to be restored to the UBOs. Traditionally such costs have been borne by the share issuers. Arguments that the UBOs should pay are a red herring. If the issuers (the companies) pay then, in effect, all the shareholders are paying pro-rata to the value of their shareholdings. This is a more efficient approach to settling the payment issue than trying to extract the money from shareholders individually.

4. Sustainability

What is required from a future Labour government to crowd in more private investment to fund the transition to net zero?

The following are required:

- Above all a clear plan of action is required which is coherent, pragmatic, realistic and achievable. Too much of what we have seen to date amounts to little more than a series of eye-catching goals and ambitions with very little (often nothing) by way of clear plans and strategies to achieve them.

- As a starting point we need a clear industrial strategy for the UK for the next 20 - 25 years. This should be reviewed and updated on a rolling basis. It must have cross-party input and support. Private investment in the transition to net zero will only be optimised if investors are clear about the government's intentions, its goals, its priorities for achieving them, how investment funding and investment might be structured (e.g. depending on the scale of the investment required and how public and private investment can be combined, or not), how risk and reward will be shared, what the anticipated outcomes are to be and by when. A further important requirement is a stable regime where incentives, tariffs and taxation are not subsequently "tinkered with" in the interests of political expediency. For economic reasons changes may be required but for capital providers to be kept 'on board' they need to be able to predict returns more reliably.

Further concerns that need to be addressed are:

- There is a serious risk at present that many areas of the net zero transition are degenerating into a time-consuming and expensive mess. Companies are required to produce more and more information for investors and other stakeholders, many of whom do not have the technical knowledge to understand or to know that they can trust what they are being told. In some cases, such as the planting of trees for carbon offsets, current measures of achievement are meaningless and some of the actions taken are positively damaging to the environment. Other opportunities, such as the mitigation of unnecessary waste (a particular issue in food and its supply chains) are failing to get the attention they deserve.

- Recent research by accountants EY found that less than 95% of FTSE companies comply with less than 50% of the new guidance from the Transition Planning Taskforce (TPT). The biggest gap is in financial planning where 79% of companies have no information on the financial plans underpinning their Net Zero strategy and only 1% align with TPT guidance.

5. About UKSA and ShareSoc

1. UKSA and ShareSoc represent the views of individual investors. Between us we have around 23,000 members. In addition to our own members, 6 million people own shares or have investment accounts with platforms in the UK.

2. The Office for National Statistics estimates that at the end of 2018 UK-resident individuals held 13.5% of the UK stock market, up by 1.2% from 2016 and moving away from the historical lows of 10.2% in 2008. In 2020, the Financial Times estimated that 15% of the UK stock market is held by individual shareholders. In addition to this there are many more who have money invested in shares via funds, pensions and savings products such as employee share ownership schemes. See https://www.sharesoc.org/investor-academy/advanced-topics/uk-stock-market-statistics/

UKSA (United Kingdom Shareholders' Association)

3. UKSA was originally formed to provide individual shareholders with a voice, influence and an opportunity to meet like-minded fellow investors. It is structured as a non-profit making company with annual subscriptions. An elected Chairman and Board of Directors (all volunteers and individuals with a wide range of backgrounds and experience) monitor a regional organisation. Each region benefits from oversight by an elected regional Chairman and Committee.

4. There are many agents and intermediaries in financial markets. Unlike them, UKSA represents solely those people who are investing their own money. UKSA and ShareSoc work together to build relations with regulators, politicians and the media to ensure that the voices of

individual shareholders and their interests in the long term public good are reflected in the development of law, regulation, and other forms of public policy.

5. We also aim to build relations with regulators, politicians and the media to ensure that the voice of individual shareholders is reflected in the development of law, regulation, and other forms of public policy. See www.uksa.org.uk

ShareSoc (UK Individual Shareholders Society)

6. ShareSoc is a not for profit company. It is dedicated to the support of individual investors (private shareholders as opposed to institutional investors). It aims to make and keep investors better informed to improve their investment skills and protect the value of their investments. It engages with companies, the Government or other institutions if it thinks individual shareholders are not being treated fairly.

7. ShareSoc actively campaigns to seek redress for private shareholders in cases where they have been the victims of unfair or unscrupulous treatment by companies and / or the financial services industry. See www.sharesoc.org