UK Shareholders' Association

The Private Investor Issue 171 · July 2014

Black Mark for BlackRock

BlackRock is the world's largest asset manager, currently responsible for assets worth $4.59 trillion. Its activities in the UK include unit trusts and investment trusts. It describes itself as *"a fiduciary investor, which means that all of the money we invest belongs to others."* In 2012, in a publication celebrating the 20th anniversary of the UK Corporate Governance Code, these words appeared on its behalf: *"We have a keen sense of responsibility to our clients to protect and enhance the value of the assets they entrust to us."*

The Sunday Telegraph recently reported that it has been BlackRock's practice to 'lend' the shares it has bought with clients' money to hedge funds. The usual reason to 'borrow' shares is to 'short' them, which means selling the borrowed shares at their current price in the expectation that the price will then drop, so that they can be bought back and returned to their owner at a lower price. It is difficult to see how this practice could benefit BlacKRock's clients, even if the money that BlackRock undoubtedly 'earned' from allowing others to make use of its clients' assets went to those clients rather than into its own pockets........

The Law Commission's recent report on what is meant by 'fiduciary' responsibility has yet to be studied by the UKSA policy team, but it seems unlikely that making use of client assets for an asset manager's own reward is covered by the term. While those who 'borrow' shares to sell them in the expectation that they will go down in price may claim they are merely anticipating what will happen anyway, those who really own the shares being 'lent' might well fear that the large scale selling implied by such hedge fund action will itself drive down the price.

BlackRock might say, of course, that it too expects the shares it 'lends' to others to go down in price anyway, but one might wonder why then does it continue to hold them? It is even prevented from selling the shares it has 'lent' until they are returned, having lost value for the clients whose interests it claims only to 'protect and enhance'. And how can BlackRock engage with company directors to improve governance, as it says it does, when at the whiff of value being lost it hands those shares to others? So much for the FRC's much vaunted Stewardship Code.

Eric Chalker

UKSA Contacts

UK Shareholders' Association
Chislehurst Business Centre
1 Bromley Lane
Chislehurst, Kent,
BR7 6LH
Tel: 0208 295 1667
Reg. Office: Chislehurst Business Centre
Email: uksa@uksa.org.uk

Website: www.uksa.org.uk

National Chairman: Chris Hulme
chairman@uksa.org.uk

Company Secretary: Elizabeth Baxter
uksa@uksa.org.uk

Membership Secretary: Elizabeth Baxter
0208 295 1667 membership@uksa.org.uk

Editor: Bill Johnston 00420 415 653 169
william.johnston.k@gmail.com
Domousice 103, 439 68, Czech Republic

Policy Coordinator: Eric Chalker 01732 835 569 policy.coordinator@uksa.org.uk

Regional Contacts:
London & SE: Harry Braund
020 7731 5942
harrybraund@yahoo.co.uk

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: Chris Hulme
chris@claytonhulme.co.uk

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

Scotland: George Miller
g.miller1010@btinternet.com

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Directors: Chris Hulme (Chairman), Harry Braund, Brian Peart (Vice Chairman) Malcolm Howard FCMA (Finance Director).

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Stop Press – 'Prudence' is coming back

As we extensively report (see pages 12-15) one of our policy team members, Roger Collinge, has been very active in the long-running campaign to restore prudence as an accounting principle. The International Accounting Standards Board has been the target for this campaign and this has now produced a result.

A new standard, to be known as IFRS 9, has just been published. This will require banks and other financial businesses, with effect from January 2018, to take account of expected losses of assets on their balance sheets as soon as these appear, not wait until they have actually occurred. The previous IASB standard required them to keep assets recorded at full value until a loss had actually been incurred. In the opinion of many, including UKSA, this led to overstating of bank reserves and their ability to withstand large losses, such as occurred in 2008.

Roger comments as follows.

"The aim of the new standard is to get banks to really account for what is seen to be happening and not just wait until it has happened. I am not impressed by the pathetic arguments that the banks will have to work a bit harder to properly assess the real value of their assets. What were they doing before? And why wait until 2018? The only possible real reason for the delay is to allow them to build up capital before then so that they will not appear insolvent when the new accounting starts.

"This is only a part of the campaign for accounts to be drawn up on a more prudent basis. As the Financial Times has rightly commented, better auditing will also be needed. Auditors will have to make judgements that they can stand by and not just simply tick compliance with the IFRS. This is part of the reason for pushing for enforced auditor rotation, in the hope that it will stiffen their sinews.

"I am surprised that the FT (Lex column, 25.7.14) thinks the new standard will make bank accounts more " pro-cyclical". It has been thought that the present system of "incurred losses" made things worse in that, as we have seen, when the losses were finally recognised under the old system, the downturn was very severe."

Well this is just the start of something big methinks. But note the main point. Publicity works. Pressure works. UKSA works.

Bill Johnston

The quality of reporting at smaller listed and AIM Companies

The Financial Reporting Council (FRC) has begun a project to evaluate and plan how it might assist smaller listed and AIM companies to address the quality of their reporting. The project follows recent reports that have expressed concern over the quality of accounts published by these companies.

Smaller listed and AIM companies are vital to economic growth in the UK but need to be able to attract investors in order to grow themselves. Greater confidence in their governance and reporting will help them access new sources of capital to support that growth.

Phil Fitz-Gerald, Head of Supervisory Inquiries – Conduct Division: "This project seeks to evaluate and plan how the FRC might assist smaller listed and AIM companies to address the quality of their reporting".

The overall aim of the FRC's project is to achieve, over a three year period, a step change in the quality of reporting of smaller listed and AIM companies. The FRC will target improvements by these companies in order to underpin confidence in the quality of reporting in the market as a whole and help foster investment in smaller listed and AIM companies. The first phase of the project will gather and assess evidence of the root causes of the challenges to high quality reporting and explore ways in which the FRC can support companies to make improvements. The second phase will look to implement possible supporting actions and the final phase will be to assess whether the quality of reporting has improved as a result.

In order to identify the root causes the FRC is carrying out a number of different activities:

Reviewing a sample of annual reports under our normal operating procedures.

Reviewing the audit procedures at relevant audit firms with respect to the processes and procedures for reviewing smaller companies' financial statements.

Meeting with key stakeholders including investors, fund managers, banks, non-executive directors, NOMADs and preparers of reports.

Consideration of the governance arrangements at smaller companies.

The FRC consults openly on all its major activities and the project team is particularly interested in hearing views from both preparers and users of annual reports on the issues and potential solution to the financial reporting difficulties faced by smaller listed and AIM companies. The FRC is keen to understand the challenges smaller companies encounter when preparing their annual reports and to obtain input on what might help smaller companies to improve the quality of their reporting. The UK Shareholders Association has an important role to play in providing input into this project and has already met with the FRC to discuss how it might help.

Anna Colban, Project Manager – Codes and Standards Division: "Smaller listed and AIM companies are vital to economic growth. Confidence in governance and reporting will help companies to grow more strongly."

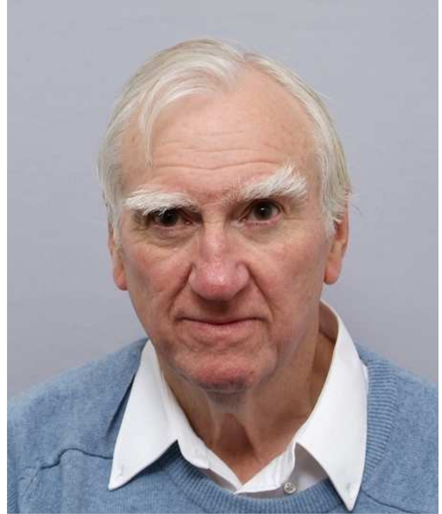
The FRC will shortly publish a questionnaire to seek input and views on the project and is particularly keen to hear from members of the UK Shareholders Association. The questionnaire will enable all UKSA members to express their individual views on the quality of reporting at such companies. Full details of this questionnaire will be published in forthcoming editions of this magazine.

Further details of the project can be found on the FRC's website at the following link:

https://www.frc.org.uk/Our-Work/Headline-projects/The-quality-of-reporting-on-smaller-listed-and-AIM.aspx

UKSA - Finance Director's Report

I am pleased to report to members that we have turned the corner and are no longer incurring losses.



Malcolm Howard
our Finance Director

In the six months to 30 June 2014, profit before interest amounted to £286. The accounts show an overall profit of £386, the difference being £100 interest earned that belongs to the Northern Rock campaign fund.

The Northern Rock campaign reserve figure shown is the opening balance at 1 January 2014. There has been no movement during the year, but at the year end the interest received will be transferred to this account.

These figures have not been audited and do NOT take into account any of the transactions that may have taken place at the branches. These transactions will be consolidated into the year end figures.

A summary of the accounts for the six months ended 30 June 2014 is shown below:

Profit and Loss Account	**£**
Subscriptions	**11,908**
Donations	**895**
Total revenue	**12,803**
Company secretarial services	**6,350**
Office rent	**196**
Private Investor	**1,936**
Annual general meeting costs	**1,974**
Directors' insurances and costs	**552**
European subscriptions	**494**
Website	**480**
Professional fees	**365**
Marketing costs	**162**

Sundry Administration costs	**8**
Total costs	**12,517**
Operating profit	**286**
Interest received	**100**
Total profit	**386**

UKSA - Balance Sheet at 30 June 2014

	£
Debtors & Prepayments	**776**
Cash	**21,858**
0.4% Bond (3 months notice)	**50,150**
Total assets	**72,784**
Less: current liabilities	**13,008**
Total net assets	**59,776**
Members' Reserves	**7,571**
Northern Rock campaign reserve	**52,205**
Total liabilities	**59,776**

UKSA - Cash Flow Statement for the 6 months ended 30 June 2014

	£
Operating profit	**286**
(Increase)/decrease in debtors	**(355)**
Increase/(decrease) in creditors	**2,516**
Cash inflow from operations	**2,447**
Opening cash balance at 1 January	**19,411**
Closing cash balance at 30 June	**21,858**
Increase in cash balance	**2,447**

Voting Power

by Eric Chalker, Policy Co-ordinator

In the past few weeks, I have attended two meetings called to increase the influence of individual savers and investors in holding company directors to account. The first, run by stockbroker *The Share Centre,* focused on the results of a survey of customers which use its 'shareholder rights opt-in' service. The second, a presentation by the charity *ShareAction*, was to launch a manifesto to give rights to users of pension funds over their investments. Both initiatives are laudable, but neither can be said to hit the button so far as UKSA is concerned.

The Share Centre, founded and majority-owned by Gavin Oldham, is the only stockbroker known to make explicit use of the 'information rights' provisions of the 2006 Companies Act. These were introduced, largely as a result of lobbying by Gavin Oldham, to offset the disadvantages suffered by investors using pooled nominee accounts. They have been frequently over-promoted in the media, stating that investors can claim these rights and that they include the right to vote, but neither is true. Sections 146/147 of the Act simply give – to the nominee only – the right to require main-listed companies to send annual reports and other information to investors using the nominee's services. Other brokers provide a similar service, but do so less formally. None of these services can be said to be completely reliable.

The only way that investors in nominee accounts can have the *right* to vote shares bought with their money is if their brokers give them the *contractual* right to do this. Whether or not there is any instance of this, it is certainly the case that some brokers do provide a *facility* to enable voting, but if this is unaccompanied by readily available information from the companies themselves, including annual reports, it will be of little use. It is also the case, of course, that if votes have to be submitted via an intermediary there is a greater risk that they won't reach the registrar. No matter how much nominee account providers try to compensate for the absence of true shareholder rights, there can be no substitute for direct ownership of shares and that is the issue which most concerns UKSA.

To its credit, The Share Centre wants to see more individual investors voting on company resolutions. It has found that only 34% of its customers who use the facility it provides actually do vote, but that is identical to the turnout in our recent elections for the European Parliament, which bears consideration. Two thirds of those who told The Share Centre they don't vote say it is because they don't think it will make a difference and no doubt many voters thought the same

on the 22nd May this year, but that cannot be accepted as a reason for denying any investor the right to vote. The right to vote is integral to democracy and while some may be content to leave routine decisions to others, they may well feel differently when asked to approve a takeover or equity issue.

One might ask, of course, why it is that resolutions approving large bonus payments still receive majority support, even when there is public agitation over the matter. As it seems unlikely that such votes come from the *un*massed ranks of individual investors holding shares directly, or using their nominees' facilities to do this, we have to look for the answer among the smaller number of more powerful shareholders, including the institutions holding shares on behalf of others. This is what concerns ShareAction, formerly *FairPensions*: it wants pension fund members to have a say in how the shares held in their funds are voted.

Pension Funds

ShareAction has published 'A Manifesto for Responsible Investment'. The title is very similar, of course, to UKSA's own publication three years ago, 'Responsible Investing'. Our objectives might be considered somewhat different, but the concept of responsible company owners is surely one that no-one can quarrel with. Probably to no-one's surprise, ShareAction's research has revealed that those who invest in pension funds have no say at all in how the assets bought with their money are chosen or managed and this is something it wants to change. It has even produced draft legislation for this purpose, in the form of a draft '*Bill to make provision for responsible and accountable long-term investment by institutional investors*'.

While it seems right to give UKSA's support to ShareAction's objective, just as we wish to see Companies Act information rights made mandatory and extended to AIM-listed companies (building on what The Share Centre started), neither tackles the bigger issue of disenfranchised investors in pooled nominee accounts. Pooled nominee account users, many of whom are in such accounts because they have no choice, must be enfranchised – given voting *rights* – if the as yet unresolved issues of corporate governance are to be adequately tackled.

Published statistics show that pension funds have been a declining influence on UK companies. A table in FTfm (the *Financial Times'* weekly fund management supplement) early this month shows their share of UK equities dropping steadily, from 17.7% in 2000 to 4.7% in 2012. In 1989, it was 30.6%. This is not the place to discuss why this has happened, but pension fund withdrawal from equities has been no secret. It has been suggested to me that the share

of UK equities held by overseas investors, which has risen from 35.7% in 2000 to 53.2% in 2012, includes overseas pension funds, but this is not borne out by any figures and it seems unlikely that other countries' pension funds would do the direct opposite of home grown funds. One does wonder, though, whether all those overseas investors, now holding more than half the shares issued by UK companies, have the same long term interest as individual investors living in the UK.

Pension savers no longer only do this through pension funds, of course. In addition to SIPPs, they also use ISAs and the latter seem likely to grow even faster now, following recent changes. Some of these investments are in unit trusts and their share of UK equities has grown from 1.1% in 2000 to 9.6% in 2012. This means that unit trusts have more than twice the voting power of pension funds, which suggests that, from a public perspective, reform of how unit trust investments are managed is of greater urgency and importance than those of pension funds. Of course, from an individual pension saver's perspective, how his or her pension is being managed matters greatly, but why should a unit trust investor, regardless of why that money has been invested, be treated any differently?

ShareAction does well to draw attention to the impotence of pension fund savers, but its target is too narrow. Surely reform should be sought to cover *all* institutional investors whose responsibility it is to manage other people's money? But this still won't deal with those who make their own investment decisions – ie choose which companies to invest in – yet find themselves without voting power over those companies.

Individual Investors

It is fashionable to decry the role of individual investors, because their number has declined. One might think there is some association here with the way in which they have been deliberately marginalised by the combined efforts of a Financial Reporting Council which places all its hopes in a Stewardship Code for institutional investors, the emphasis on counting proxy votes at the expense of hand votes (which originated with Lord Myners, despite his long-standing support for the role of individual shareholders), company chairmen who see them as little more than an irritation and stockbrokers who have taken away shareholder rights by offering fewer opportunities to enjoy them. However, are private shareholders really such a small constituency that they can be ignored?

The share of UK equities held by individuals in 2012 was 10.7%. We can observe that this is significantly more than twice the share of pension funds. It is almost equal to the combined share of pension funds and insurance compa-

nies (10.9%) and if 'other personal sector' holdings are included (0.6%) personal holdings equal as much as 37% of all UK institutional holdings (30.8%). Moreover, if overseas investors are discounted and we are measuring only the holdings of UK residents, individual holdings are nearly one quarter (24%).

And why is nearly as much invested in unit trusts as in company shares held directly? If there was more understanding of equity investment among the general population, beginning with school and supported thereafter by government, is it not likely that more savers would choose to avoid unnecessary fund management fees (which often amount to little more than rent) and enjoy a direct relationship with listed companies? The media have something to answer for here, as there is a huge bias in its reporting towards funds (often misleadingly described as equities), rather than shares per se.

So, back to the subject of voting, we can assume that pension fund managers and unit trust managers vote as they wish, without particular regard to the interests of the people whose money they manage. They are, in effect, unaccountable except to themselves. Given that all asset managers are part of the financial services industry and all of that industry lives unashamedly on other people's money, we can assume that they see themselves as privileged to understand issues such as pay and bonuses much better than the *hoi polloi* and vote accordingly. To break that link, voting power must be taken away from those whose job is management and given to those whose money it is.

That's easier said than done, because the financial services industry has acquired such a tight grip. It is why so many investors, who would be share owners if they could, have been forced into pooled nominee accounts instead. What happens to the voting rights of their shares if they either don't, or can't, vote via their nominees?

One broker's practice has come to light. Brewin Dolphin, which does provide a voting facility for its customers, told ShareAction that it, "*votes its shares in line with clients' wishes where instructed, voting the remainder of the shares according to its house position......*" There you have it: in addition to pension funds and unit trust managers, even providers of nominee accounts will vote as they choose the shares under their control, except for those for which they have received specific requests.

Something more is needed to give voting power back to where it belongs – the individual whose money it is. I am working with the UKSA policy team on an initiative to do this, which I hope to report in the next issue.

Eric Chalker, Policy Co-ordinator

Directors' Responsibilities

The UK Shareholders' Association continues to fight for better corporate governance and the better accounting that goes with it. One matter of concern has been, what should be meant by the term "going concern"?

For many years company directors have been required to ensure and believe that their accounts are drawn up on a "going concern "basis. In practice this has always been the case, as to use any other basis could only mean that the liquidator was at the door.

However, in 2011, a panel under the chairmanship of Lord Sharman suggested that consideration of going concern should be expanded to embrace what it called a "stewardship" basis. The idea was to require directors to consider a longer period, consider matters more broadly and make an overtly positive statement. The Financial Reporting Council (FRC) is now struggling, against director opposition, to have this incorporated in a revision of its Corporate Governance Code.

To overcome the resistance, the FRC has come up with a compromise, but the coalition of pension funds and other major investors with which UKSA has now been working for some time feel this is not good enough, so we have sent our joint thoughts to the FRC. This is the document which has been produced.

The going concern statement underpins stewardship – a long-term investor view

Introduction

Whether or not an entity is a going concern, and likely to continue in operation for the foreseeable future, is of vital importance to all stakeholders. Directors' confirmation that they believe a company is a going concern underpins the trust placed in it fulfilling its obligations. While the legal framework around how directors assess and communicate their opinion on companies' continued viability has been strengthened over time, the financial crisis – and the revelation of solvency issues in banks – exposed limitations in practice.

Long term investors need a robust stewardship going concern statement

We welcome the UK Government's commitment to implement the

recommendations of the Sharman Inquiry (2012) to tackle these failures. Of particular significance to long-term investors is the clarification and strengthening of the "stewardship going concern" statement alongside the more widely understood "accounting going concern" assessment; the requirement for directors to consider longer-term solvency risks taking into account business cycle and other economic and financial factors; improved disclosures around the risks and assessment process; and an auditor opinion of the going concern disclosures1.

1 The Sharman Inquiry. "*Going concern and liquidity risks: lessons for companies and auditors*" Final Report and recommendations of the panel of inquiry. June 2012.

A stewardship going concern statement, with supporting assessments and disclosures, is vital for two reasons:

1. To reassure the providers of capital (and other stakeholders) over the company's ability to continue to operate, and meet reasonably expected liabilities as they fall due. This is a matter of both liquidity and solvency.

2. To make clear directors' responsibility to manage the company prudently and for the long-term, not just to focus on short term challenges.

Taken together, the statement plays an important role in ensuring long-term and prudent behaviour, protecting capital, and strengthening responsible stewardship. This in turn underpins economic resilience and growth.

Key elements of a stewardship going concern statement

An explicit assertion by directors about the entity's expected future viability. The going concern statement represents directors' best judgement of the entity's ability to continue in operation into the foreseeable future.

Supported by a clear articulation of business risks to the outlook. While the statement sets out directors' opinion of the company's future, the risk assessment should provide an indication of the possible variation around this projection.

Grounded in 'true and fair' accounts. The accounts must provide a reliable and prudent view of capital, including distributable reserves, such that directors have a solid basis on which to form a view about the future.

Covers the foreseeable future. While directors should set the appropriate time frame (and justify this choice), the period of consideration should be considerably longer than the 12 months used for accounting purposes, and take into account the business cycle and other economic and financial factors facing the company.

Is a judgement, not a guarantee. Directors are expected to provide their reasonable expectation of the company's viability based on available information at the time. Directors should not be held accountable for unfore-seeable eventualities, and should be protected by safe harbour provisions.

A proposed stewardship going concern statement

The proposed statement below – with supporting guidance – meets the aims we have set out above, and is in keeping with the recommendations of the Sharman Inquiry.

The directors should confirm in the annual report that they have carried out a robust assessment of the state of affairs of the company and any risks, including to its solvency and liquidity that would threaten its viability. They 17 June 2014 *should state whether, in their opinion, the company will be able to meet its liabilities as they fall due and continue in operation for the foreseeable future, explaining any supporting assumptions and risks or material uncertainties relevant to that and how they are being managed*.

Supporting guidance:

First sentence: there needs to be specific reference to the assessment giving consideration to the audited accounts and financial controls and to the specific issue of whether there is a risk that the value of the company's assets may be less than the amount of its liabilities, taking into account its contingent and prospective liabilities.

Second sentence: It needs to be made clear that 'foreseeable future' cannot be limited to 12 months and regards should be given to such things as the business cycle, contract lengths, the liability – including contingent liability – profile and other identifiable factors.

The statement should be required as part of the Financial and Business Reporting section of Corporate Governance Code.

Key areas of concern with recent Government proposals

The Financial Reporting Council is now consulting on modified requirements relating to the going concern assessment and statement in the Corporate Governance Code to put recommendations from the Sharman Inquiry into practice2. Several proposals have been put forward which we find troubling. These are outlined below.

Subsuming the "Longer-term viability statement" into risk management - The going concern statement should not be subsumed within the *Risk Management and Internal Control* section of the Corporate Governance Code. This would frame the Going Concern assertion as a risk statement, which it is not.

The assessment of risks should be holistic. Risks around the director's central projection need to be disclosed. This must not be limited to "principal risks" as currently proposed, but consider the risks to the business in the Proposed round.

Reference to accounts is important. We believe the reference to audited accounts in supporting guidance is a critical part of any stewardship going concern statement as it makes clear the need for directors to root their judgement about the future in a firm understanding of the current capital position. Currently this is missing.

Specific terminology should not prevent progress. We appreciate that terminology like "going concern" and "foreseeable future" is considered confusing by some. We are willing to consider alternative wording as long as the underlying principles set out in this paper are upheld.

As usual in this highly-important matter Roger Collinge is sporting the UKSA colours.

Roger Collinge

In the letter which is reproduced here he was one of ten signatories representing an important cross section of heavyweight investment experts.

Again the efforts of the group were well reported in the press and indeed appear to be bearing fruit (see Page 3).

Private Equity, Indeed

Secrecy… opacity… lack of transparency…obfuscation… deceit…where you have markets worth billions or trillions of dollars, it's axiomatic that you're going to have people trying to exploit them in ways that, if not criminal are certainly highly dubious. Sometimes, these people come damned close to collapsing whole national economies, as we saw with the sub-prime banking crisis. Often, it isn't obviously at the time that the actions taken by these people will have unintended consequences. Apparently, it's not even obvious to regulators, who supposedly have the skills to protect us from scandals such as market abuse or manipulation. When the regulators finally wake up to the danger, it's often too late, and the damage has been done.

High-Frequency Trading

For example, I've been banging on about the dangers of high frequency trading (HFT) for years. It's only fairly recently that regulators have woken up, and are now doing some serious investigation. Even our own Financial Conduct Authority is belatedly getting in on the action. Earlier this month, it launched a review of competition in the wholesale securities market. Mary Starks, the FCA's director of competition said: "*We are interested in any feature of a market or behaviour that could inhibit or distort the healthy functioning of competition in the market*". Such factors include the role of high-frequency traders, and the practice of "co-location" – allowing traders to place their servers in the same building as those of an exchange's trade-matching engine, to enable those traders to receive market information and submit, amend and cancel orders faster than anyone else.

The FCA is behind the curve. Many other regulators are already on the case, notably New York's Attorney-General Eric Schneiderman, who has already described high-frequency trading as '*Insider Trading 2.0'.* Right now, the regulators are pretty busy, what with allegations concerning HFT, the manipulation of interest rates, the gold price and foreign exchange rates, and so on. As fast as a spotlight is shone on one scandal, another two heave into view. In a way, it's a bit like the child abuse scandal. Not so long ago, we used to think that this was the province of a tiny coterie of perverts. Yet now we find that, just below the surface, it has been growing like a cancer, with people from all walks of life involved – criminal gangs, TV celebrities, politicians, the churches, hospitals, care homes, schools, the family… even the police, who appear to be implicated in an organised cover- up.

When bad things go on in the financial services industry (or indeed in any industry), naturally they tend to go on in secret. If you're treading just the wrong side of that fine line between legality and criminality, you won't want to advertise the fact. So you'd think that one of the best weapons in the regulators' armoury would be transparency. In the case of equity markets, most people probably believe that we do indeed have that transparency. The London Stock Exchange is a regulated entity with publicly-displayed prices for every instrument traded. The public now even has access to 'Level 2 prices'. A Level 2 screen shows a greater depth of data than a Level 1 screen by allowing you to see every bid and offer placed in the market by all market participants. You can download a useful LSE guide on Level 2 prices by entering this URL into your browser: *www.londonstockexchange.com/pricesand-markets/stocks/tools-and-services/ level2/level2guide.pdf*

'All professions are conspiracies against the laity' (George Bernard-Shaw)

So at least all is well in equity markets, yes? Well… no, actually. To give one simple example, take a share such as *AA,* the roadside assistance group, which floated recently. Perhaps some of you fancied buying it on the first day of trading in the hope of making a quick profit. If so, we hope you took the time to read the prospectus first, as any prudent investor should. You didn't? Why not? Ah yes, of course… there wasn't a prospectus. Or to be more precise, there was one. It's called the "pathfinder" document, which is basically the prospectus minus the launch price. But it's kept secret from private investors until after the flotation. Only institutional investors are allowed to see this document. If you decided to buy AA on its first day of trading, you were basically trading blind. The pathfinder rules only apply to initial public offerings where the shares are being offered to a select group of institutional investors.

Where shares are being offered to the retail market (a public offering), the prospectus does have to be made available ahead of the float. Nevertheless, the secret pathfinder route reinforces suspicions that the market is rigged against private investors, and in favour of the institutions who have the potential to make a big profit on the first day of trading. There you have a very simple example of a lack of transparency that is condoned by regulators. But there's a MUCH worse example than that; and I've touched on it before.

'And now we see through a glass darkly' (St. Paul)

About ten years ago, almost all equity trading was carried out on centralised exchanges, such as the London Stock Exchange, the American Stock

Exchange and NASDAQ. But now, more than one-third of equity trading takes place in secrecy or semi-secrecy in so called "dark pools", private trading venues run by banks and other institutions that match buyers and sellers directly. There are currently around 50 such dark pools across the US. What's the purpose of dark pools? The banks say that it's to enable their institutional clients to trade large blocks of shares without signalling price shifts to the market. As large share transactions can distort market prices, this is not such a bad idea. But read on.

In the case of *Barclays'* dark pool, Barclays LX, the bank also claimed it had safeguards in place to protect against "predatory" high frequency traders. Now there's an interesting bit of information.

The industry has always claimed that HFT benefits markets by, for example, increasing liquidity and reducing transaction costs. But according to Barclays, HFT is bad for its clients, who have to be protected from the "predatory" activities of HF traders. But that's by the by. The central point here is the transparency-versus-opacity dichotomy. Where transparency gives way to opacity, bad people lurking in the darker corners of the dark pools will try to get away with doing bad things

Sure enough, New York Attorney General Eric Schneiderman has filed a lawsuit against Barclays for misleading its clients. Apparently Barclays heavily promoted a service called 'Liquidity Profiling', which it claimed was a "surveillance" system that tracked every trade in the dark pool in order to identify predatory traders. The New York Attorney General's office claimed Barclays "*has never prohibited any trader from participating in its dark pool, regardless of how predatory its activity was determined to be; did not regularly update the ratings of high-frequency trading firms monitored by Liquidity Profiling; and assigned safe ratings to traders that were otherwise determined to be toxic*".

Indeed, the attorney-general's office goes further. It claims that Barclays actually favours predatory high-frequency traders, so as to give these traders advantages over other investors. Barclays "*falsely underrepresented the concentration of aggressive high-frequency trading in its dark pool; failed to provide many of the benefits marketed with the Liquidity Profiling service; and favours its own dark pool when routing client orders to trading venues*".

In short, not only did Barclays not have safeguards in place to protect clients against "predatory" traders; it actively encouraged HFT. It did this so to increase its market share and to maintain liquidity in the pool. It also sent a "disproportionately large percentage" of its own client trades to Barclays LX, thereby exposing its clients to HFT activities without their knowledge and to

their detriment. Of course, Barclays hasn't been found guilty yet. But we wouldn't advise you to place bets on its innocence. Barclays already has form. In 2012, it agreed a £290 million settlement for its part in the Libor scandal; and only in May, it paid a £26 million fine for one of its traders manipulating the gold fix. Trouble is, as the *FT* pointed out a couple of weeks back, big fines imposed on banks by regulators are making it a nightmare to value banks accurately.

Barclays' fines are trouser fluff compared with some of the other banks, notably the near-$9 billion fine imposed on French bank BNP Paribas for violations of US economic sanctions laws. Assuming Barclays is indeed found guilty as charged, we contend that the central problem here is the lack of transparency. We don't know who coined the phrase 'dark pools' but they are perfectly named. Where there is darkness, secrecy and opacity, it's so much easier to hide things that people want to be kept from prying eyes.

What's the solution? There are two things that should be done. First, regulators could ban dark pools. This is what established exchanges such as Nasdaq are pushing for. The banks would no doubt squeal that this would undermine liquidity. Let them squeal. They didn't squeal in the years before dark pools were invented.

The other possibility is that the regulators should demand access to the information streams from the dark pools. Regulators could not check every transaction, but they could certainly feed the data straight into analysis software that could produce graphical 'heat maps' of prices and order flows.

Rob Cullum

This article is an edited version of a longer piece which appeared in *Trend-Watch* magazine written by its editor Robert Cullum whose eye for a story and unmistakable style regularly enlivens our pages during the summer months when momentum in progressing the bloc of policies which are UKSA's current preoccupations slackens as the holiday season predominates.

Barclays is now at the first stage of its challenge to Eric Schneiderman its defence at this stage apparently limited to challenging his jurisdiction.

Incidentally Roger Collinge says that anyone interested in how accounting is developing the International Accounting Standards Board have just published their first Investor Update in fairly plain English. It is available on their web site wwww.ifrs.org. And the message from Eric Chalker is that www.thismoney.co.uk is a click of the mouse worth making too.

Bill Johnston

Letters to the Editor

Dear Sir,

Beware of Scams

My wife and I have been sleepy members for many years and thought it worth a mention that an old scam has reared its ugly head again with *Croma Securities* shares that we hold.

The actual price is around 30 pence as of now, whereas a Scam caller will suggest a specialist entrepreneur is willing to pay silly money usually 5 to 10 times the market price to buy your shares. However to get this horrendous pay-out you have of course pay up front a percentage first as an Indemnity, supposedly to make it all work, but of course if you do you will never see your money coming back as promised by the Scammer.

This is about the 4th or 5th time we have been pestered over the last 2/ 3 years. Previously I have located Fake M and A Investment websites emanating from these suspicious calls which come from America. I called the SEC at the time and they got the websites removed but on it goes.

Croma Securities are aware of this Scam and also their Registrar, *Neville's.* I was also told in the past that they are not the only company that is being being targeted in this way.

Hopefully our members are still on their guard but a little reminder might not go amiss.

Marshall Summers

Dear Sir,

Selftrade

The interesting articles by Eric Chalker and Martin White on Selftrade give two sides of the same story. It is very apparent that many of Selftrade's customers were very unhappy with the information requirements because they first announced a reduction in the requirements culminating in my receiving a letter, in answer to my complaint, that no further information is required and confirming that no information will be used for marketing purposes.

Like Martin I use Selftrade mainly with TD Direct investing secondary and agree with all his comments. Every time I have wished to vote or attend an AGM both organisations have complied without any fuss. However, the takeover by Equinity of Seftrade is very worrying and only time will tell.

Edgar H Ring

Dear Sir,

Broker services: are you happy with yours?

I'm writing this as a letter to the editor rather than as an article, because I'm hoping many members will reply in the same way. Bill Johnston would no doubt like more members to write articles, but perhaps that looks too daunting, whereas writing letters is much easier. So please do! We need comparative information of this kind.

The broker scene is changing. There are a number of reasons for this, but ultimately they are all commercial. Brokers need to make a living and much of this is at our expense as investors. In return, they provide a variety of services. These have been changing, as have the charges. When dealing in certificates, of course, the only charge is commission, but not all brokers will provide this service. By and large, brokers want to hold your investments in pooled nominee accounts, which of course means they own them and can charge you rent. Such rent comes in a number of forms.

As this is a letter, not an article, I will focus on just one broker service: this is the provision of company reports. For me, it is an important requirement. I do not want to read company reports on a screen and I do not want to pay to print them myself. They are a necessary expense for any public company to tell its investors what it is doing with their money, so I expect to be kept informed without having to keep a diary note or watch a website. My experience of broker provision of this service, for shares held in nominee accounts, covers *Hargreaves Lansdown* (HL) and *The Share Centre* (TSC).

Both HL and TSC offer to provide company reports. HL charges £24 a year for this, but it would be free if I were not already paying that charge for printed half-yearly reports on my investments. TSC does not make a charge for this service. The other difference is that TSC uses its rights under Part 9 of the Companies Act for fully listed companies whereas HL (inexplicably) does not. In practice, some companies simply fail to act on HL requests (BlackRock investment trusts being notable examples), whereas TSC failed (inexplicably) to act upon my 'opt-in' request for its 'shareholder rights' service and this took time to correct.

So with both HL and TSC it's an imperfect service, but so far this year HL is proving the more reliable, although TSC may score better in other ways. Interestingly, in neither case is any change made to share registers, as the registrars maintain separate records for such requests – which tend to continue after the relevant shares have been sold.

Eric Chalker

Regional Information

These events are open to members from all regions, and their guests, unless otherwise indicated. For 'waiting list' events all places are taken but there is a waiting list for cancellations.

LONDON & SOUTH-EAST

All events must be booked in advance via the specific organiser. Future events are shown in this magazine and on the UKSA website. Members from other regions are very welcome. For more information please contact Harry Braund on 020 7731 5942 or email harrybraund@yahoo.co.uk

Within this region there is a separate Croydon and Purley Group which meets in Croydon, usually on the second Monday of each month, at the Spread Eagle pub, next to the Town Hall. Please contact Tony Birks on 01322 669 120 or by email ahbirks@btinternet.com ,who will confirm actual dates. There is no charge and no booking necessary.

MIDLANDS

For general information, contact Peter Wilson 01453 834486 or 07712 591032 or petertwilson@dsl.pipex.com

At the present time no meetings are being arranged specifically for the region, but members are cordially invited to attend meetings in the North or South West regions where they will be made very welcome; or indeed London if that is more convenient.

SOUTH-WEST AND SOUTH WALES

All South-West events must be booked in advance, and are open to all members and their guests subject to availability.

Didmarton: The King's Arms, Didmarton: cost is £22.50, including coffees and lunch. Events are at 10 for 10.30am. To book, contact Peter Wilson 01453 834486 or 07712 591032 or petertwilson@dsl.pipex.com

SCOTLAND

For information on Scotland please contact Mr George Miller at g.miller1010@btinternet.com

NORTH-EAST

Advance notice is required for all company visits and lunches. Knaresborough: venue is the Public Library, The Market Place, Knaresborough. For more information (except where stated otherwise), please contact Brian Peart, 01388 488419.

NORTH-WEST & NORTH WALES

For details of events, please contact D. L. King, 01829 751 153

Better Finance

Gabriel Bernardino, the Chairman of the European Insurance and Occupational Pensions Authority (EIOPA), gave an impassioned and encouraging speech on '*EIOPA's priorities for consumer protection*' at the BETTER FINANCE conference in Reykjavik, organised in cooperation with its Icelandic member, the Icelandic Savers Association.

"The reality is," Mr Bernardino declared, ***"we created a monster. ...giving more information to consumers doesn't work. Most people don't read or understand the lengthy pages containing complicated product information. ...what we need is 'smart disclosure', with a focus on consumers."***

Mr Bernardino praised BETTER FINANCE (the new motto of the European Federation of Financial Services Users) as sending out a '*very good message*' and stated that the only way the lack of trust in the financial system can be addressed, is by putting consumers back at the centre.

He then alluded to a changing world, with the internet generation increasingly expecting comparability between products and transparency and integrity from the financial services that provide them.

Due Diligence

Our traders might be tempted to use their muscle in ways which the rest of us might think detrimental to the proper workings of the market; the panjandrums of the financial services' industry might think that to examine and address the problems of mere individuals would be just too wearisome and - even worse - might cost money; so it is with relief that we turn to the peerless members of a great British industry dealing with factual matters where only the numbers are allowed to prevail (accountants) and where words express exactly what they are meant too (lawyers).

This little note is not meant to express cynicism - by and large I think that due diligence in London works.

But for the private investor there is still much to perplex. For example radiation technology group *Kromek* plunged when the group, the ink on the prospectus hardly dry, announced that the building blocks upon which its short-term prospects rested had proved to be fissiparous. How we ask given the forensic scrutiny to which new issues are subject, could this happen?

And look at the well-publicized and deadly assault on the *Quindell Portfolio* by the short-sellers. The share price still trundles along at what is surely a fraction of what it should be if the *de facto* endorsement of its professional advisors were soundly based. For heaven's sake, the company not long ago raised £200 million!

Of course a prospectus and a balance sheet are the responsibility of the directors. Much good that does to those of us wondering what to do in such situations as I have described here.

And here is another thing. When corporate capsizes happen, the position of the private investor is akin to the victim of a crime; that is, being totally ignored whilst the lawyers and the psychiatrists et al swarm over the perpetrator. When spread-betting company *WorldSpreads* (remember that) went belly-up I lost a lot of money. You may know or you may not that the investor funds here which were supposed to be ring-fenced had somehow seeped into the company accounts and evaporated considerably in the process without the auditors having noticed. What happened? How was the trick pulled? As a loser you would think that I might at least have the satisfaction of getting a good read out of it. No chance.

What to do about it? Spread your risk and remember that to live well is the best revenge.

Bill Johnston