UK Shareholders' Association

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Chairman´s Commentary

It seems a very short time since the last issue. In a sense it is, because Christmas and the New Year have made it a very brief two months since the last issue. We have our next Board meeting on February 9 and there will be more to report after that.

One of the pleasures of this new job is learning about the unsung stalwarts of the organisation. I made a gentle enquiry about events in the North-East, of which I had heard little, and was rewarded with an extensive email from Julian Mole detailing the events of the last year with a helpful commentary, and an apology for being too busy to report before (I suspect he hadn't been asked). I'm ashamed to say I had not previously heard of Julian. I must get up to one of his meetings.

Welcome to Midlands member Peter Parry who replied to my request for some help in connection with a potential project with High Pay Centre and was rapidly recruited to help more generally with policy. This brings the number of such recruits in the last six months to three, and I would guess a doubling of the fire-power of the policy effort.

While we are on volunteers, 'Better Finance' in Europe is looking for a 'person with legal background and training' to join its legal Committee. At least one trip to Europe at own expense would be required. As you know, Harry Braund is one of the seven directors of 'Better Finance'.

We had 24 new paying members in the last quarter, which Liz tells me is the largest quarterly total for at least five years. My understanding of statistics and probability prevents me making too much of this. If I fail to mention the same statistic in subsequent quarters that will also be a good example of 'data mining'. But I can't quite stem a feeling of quiet encouragement.

The problem is of course that there is a steady stream of lapsed memberships, almost entirely due to age. We have to work particularly hard to correct our age profile. But given the seminal importance of our mission and its publicly visible increasing effectiveness, a sea-change is undoubtedly under way.

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In this issue…

John Hunter

Here is something more immediate. We have spent some time (kindly donated free) with David O'Hara, who designed our website (written in a difficult language called Drupal), so that we can now make changes to the site (which we could not make before) and we are gradually doing so, as time permits. This has a number of consequences:

All websites start riddled with errors. The reason they end up un-riddled is that users email the webmaster to report them. Please make use of the webmaster link on the Contacts page to do so. (I have found that some links, including contacts, are slow to open. Please be patient, or stick the webmaster address into your own contacts list to speed it up).

I am keen that the site has a much greater range of material. That means a greater range of people producing it. As always this needs volunteers. Those of you thinking of putting your names in this particular frame should, as always, contact me. No technical web knowledge is required, but an understanding of the principles of web-writing is. This is the best link I've ever found for that: http://webwisewording.com/web-writing-tips.

…and it occurs to me that if you (or your partner?) don't know or care about equity investment but do understand writing for the web you might like to amuse yourself by taking our own no doubt brilliant material and turning it into something which people are actually going to bother to look at.

The fact that I am webmaster is a bottleneck and likely to become more of a problem rather than less so. This is a job that can be carved up among many people if no single person wants it. Volunteers please.

I think the technical factor which is that of the use of the Drupal language may eventually force us to re-write the site. I'm told that you can put up a respectable site in a day using Wix or Weebly (no, me neither). No doubt there are other templates to choose from. Advice is sought (or, better, a day's work to put up a sample) - please!

I am currently fertile ground for ideas and suggestions. Please take advantage of that. It's your website, not mine. My email address is on the site.

All these things can be done at home in your own time. Over to you! I wish you a happy and safe New Year and, as always, good luck. **Incidentally, the date of the AGM is provisionally fixed for Saturday 25th April at 2pm.**

John Hunter

Shareholder rights in the EU

by Eric Chalker

In July 2007, the EU adopted a Shareholders' Rights Directive (SRD), which was intended to facilitate the exercise of basic shareholders' rights and solve problems in the cross-border exercise of such rights, particularly voting rights. An EU directive is an order to member states' governments to find ways of changing their laws to meet its requirements. At a later date, the EU issues regulations which prescribe how certain things must be done. The Companies Shareholders' Rights) Regulations, which implemented the SRD, were adopted in July 2009.

Information about the SRD and the regulations can be found here respectively: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2007:184:0017:0024:EN:PDF and http://www.legislation.gov.uk/uksi/2009/1632/pdfs/uksi_20091632_en.pdf .

Cross-border voting

In April 2014, the EU Commission published proposals to amend the Directive because it wasn't satisfied with the way it had been implemented in all member states. When this first came to my notice, I gave it a low priority, believing it was unlikely to affect the way things are done in the UK. One particular concern of the Commission, for example, is to improve cross-border voting and while this is quite a major issue for other shareholder associations in Europe (and not just those in the EU) it has not been an issue within UKSA (although, as you can see on page 6, UK investors in non-UK European companies can have the same problems).

The particular problem we have with the existing SRD is that it does not address the peculiarly British problem of beneficial owners of shares held in nominee accounts who, in the main, lack any shareholder rights at all other than the right to dividends and the sale value of the shares. It has taken a long time to be certain of this, but it has become apparent that UK investors holding their shares in nominee accounts are unique in this respect. It is for this reason that, until recently, we had been unable to persuade the officers of EuroFinUse, now known as Better Finance, to take up our concerns with the EU; we had not understood why other shareholder associations were not affected and they did not understand what we were bothered about. This is despite strenuous efforts by our two representatives, Harry Braund and Martin Morton.

This has now changed. Earlier this year I was able to meet Guillaume Prache in London (at St Pancras station, while he waited for his train) and in the space of an hour laid before him the scale and detail of how an estimated half of UK investors are disenfranchised and at risk because there is no direct link between them and the issuers of their shares. We now have the full support of Guillaume and his staff in seeking the changes we need.

Wiesbaden

Last month, I joined Harry and Martin in Wiesbaden, for the annual meeting of the EuroFinUse General Assembly. The subject of the SRD was up for discussion, because other shareholder associations aren't entirely satisfied with what the Commission is proposing. The draft replacement SRD has moved to the European Parliament, where detailed consideration is the responsibility of the committee on legal affairs, known as JURI. I have written to a senior British member of JURI, Sajjad Karim, to ask for a meeting, as I suspect that even our MEPs are ignorant of the fact that, in UK law, investors in nominee accounts are not shareholders, therefore the current SRD proposals, as with the original SRD, will have no effect on them whatever.

With the assistance of EuroFinUse staff and Christiane Hoelz of DSW, the German shareholders' association, I have drafted amendments for consideration by JURI, which would extend the rights which the EU wants for shareholders to beneficial owners in pooled nominee accounts. If such provisions were to be adopted by the EU, the UK government would eventually have to implement them, so this is one potential way of achieving what we want, but I am not able to form an opinion on the likelihood of this.

It should not be necessary to go through the EU to achieve legislative changes that the UK government ought to making without such prompting and perhaps it won't. There are pleasing signs that, within the Department for Business Innovation and Skills, the letter of support we received in the summer of 2013 from Jo Swinson MP, a minister in that department, really meant what it said. But there is a long way to go, with a general election on the horizon and a hostile financial services industry fiercely protective of its "right" to make money from our investments, so progress at best is likely to be incremental, but that may get us where we want to be.

Owning non-UK European shares

That conference in Wiesbaden, Germany, raised matters of concern to private investors. As you will know from articles and reports in *The Private Investor*, the UK Shareholders' Association joins with similar associations from other European countries to tackle matters of common concern. One particular cause of concern is the difficulty of exercising shareholder rights across borders, which particularly acute in respect of voting rights.

We are fortunate in the UK in having a very large number of companies in which it is easy to invest without needing to look for them in other countries. That is not true for private investors elsewhere in Europe and it is a major reason why they often buy shares in companies which are not listed in their home countries. Despite this, they have the same desire as we do to participate as members of those companies, including the exercise of voting rights.

Our fellow associations are tackling the impediments to cross-border voting by seeking amendments to a shareholders rights directive currently under EU consideration. UKSA also wants amendments, to overcome the difficulties many of us have even trying to vote in our own UK companies, but I found myself wondering whether UK investors have similar problems in cross-border voting, so with Liz Baxter's help I surveyed the membership.

Just nine members came back with relevant information, so it appears that very few of our members have this problem. French and German companies feature the most, followed by Swiss and Spanish, tailing off with Finland, Italy and Norway. In less than one fifth of these investors' experiences have they been given the opportunity to vote, even though their shares are held directly. One advisory broker, Killick & Co, appears to be particularly good at facilitating voting and one UKSA member owns a company which assists the process, but otherwise UK investors seeking to exercise shareholder rights across borders are as frustrated as their continental cousins.

Sometimes, what we think is a UK company turns out not to be so. I confess to that of Wolseley plc, in the FTSE 100 and bearing a reassuringly English name – but it's actually Swiss and AGMs are held in Zug! Our member with shares in Wolseley reports, *"You have the surreal situation of the Chairman sitting with all the board members in Zug speaking to a row of empty chairs – no shareholder has ever attended in Zug to ask a question – and his words are then transmitted to the shareholders sitting in London who are only too keen to ask questions and make comments. The ultimate irony is that when a shareholder takes the trouble to attend the AGM in London to ask a question that might affect how he or she would vote, they are advised that only shareholders in Zug can vote and everyone else has to vote by proxy two day before the meeting!"* Some members are put off even trying to invest abroad by the cost of converting dividends into sterling and by tax issues, but one member told me that an investment in France and another in Germany had made him "pots of money" so perhaps the rest of us should not be shy, despite the current impediments to shareholder engagement with company boards.

Eric Chalker, Policy Director

The Accounting Story

This is the title of a very readable paper that can now be found on UKSA's website. It is worth having a look.

Written by Roger Collinge FCA, our head of corporate governance, its purpose is to trace the history and purpose of accounting, identify and explain the essential ingredients and highlight the actions which need to be taken to align present accounting standards more closely with their original purpose.

Our policy team has long been campaigning for the restoration of prudence as a principle at the heart of company accounting standards. We have done so in conjunction with a coalition of major institutional investors, comprising pension funds and other funds investing other people's money, as has been reported here from time to time. UKSA's participation has been led by Roger, now retired from his profession but maintaining many contacts and using his knowledge to good effect.

Not everyone thinks the same on this subject. Some continue to stand by the 'fair value' concept embraced by the International Accounting Standards Board, but UKSA's position is that the introduction of this was a major factor in allowing the banks to inflate their reported profits and subsequently destroy shareholder value. We believe changes must be made to prevent this and similar lapses in stewardship from ever happening again.

Getting company accounts right

The job of setting accounting rules for UK companies has been delegated by Parliament to a body called the International Accounting Standards Board (IASB). That body has accepted that its standard which dealt with bank bad debts was inadequate and it is now part of the way towards improving the situation. It has recently proposed a new standard on this topic.

However, in the EU, before any new standard is adopted, it has to be endorsed by a body called EFRAG (European Financial Reporting Advisory Group). So far this body has not endorsed the new standard, known as IFRS9, nor even given a timetable for doing so.

IFRS9 is the IASB's proposed accounting standard for financial instruments. **Wikipedia** defines a financial instrument as "*a tradeable asset of any kind; either cash, evidence of an ownership interest in an entity, or a contractual right to receive or deliver cash or another financial instrument*." **Investopedia** gives it as "*a real or virtual document representing a legal* *agreement involving some sort of monetary value: in today´s financial marketplace, financial instruments* can *be classified generally as equity based, representing ownership of the asset, or debt based, representing a loan made by an investor to the owner of the asset*."

Roger Collinge

Clearly, sound accounting for financial instruments is integral to the provision of reliable accounts, but EFRAG has yet to provide investors with a standard whose implementation would restore investor confidence. So, one might ask, who are the members of EFRAG? One thing is certain, none is a representative of those who put their own money at risk (sometimes described as "end users") which of course includes all of us. UKSA and Better Finance (previously EuroFinUse) have tried to remedy this and will continue to do so.

EFRAGILITY

EFRAG exists to give technical advice on accounting matters to the European Commission and to provide input to the international financial reporting standards (IFRS) that are the IASB's responsibility. Ultimately, its job is to advise on whether IFRS should be adopted in the EU. In the opinion of many observers, including Roger Collinge on behalf of UKSA and the Europe-wide organisation to which we belong, Better Finance, EFRAG has not been doing a good enough job.

In November 2013, at the behest of the EU, the 'Maystadt Report' was published and has since been adopted. This proposed a new "high-level board" with 16 members: 4 being European public institutions, 7 being "national standards setters" and 5 being "stakeholders" – industrial and trading companies, financial institutions, accounting professionals and "users".

A "user" member of the EFRAG board was to be "*proposed jointly by the associations representing private investors (the "end users") and financial analysts*." However, it is hard to see that these two groups have identical perspectives, which suggests that the proposal was inherently flawed and perhaps deliberately so.

It may therefore not be a surprise that despite Better Finance, on behalf of all its private investor association members, including UKSA, putting forward a very well qualified candidate in Ms Jella Benner-Heinacher, chairman of DSW (the German shareholders' association and vice-president of Better Finance), a financial analyst was chosen instead. How this was done "jointly", as Philippe Maystadt proposed, is not yet clear, but the decision was made by a 7-

member nominating committee whose UK member was Stephen Haddrill, CEO of the Financial Reporting Council.

EFRAG has to be funded and it appears possible that seats on its board may have gone to those bodies which can pay for them. Clearly such a financial commitment would be beyond an association of individuals dependent on their subscriptions, but one might have thought the EU itself would want the voice of true investors to be heard. But then again, the voice of the financial services industry will always be heard more clearly than the collective voice of ordinary people, unless elected politicians ensure otherwise.

Eric Chalker, with the assistance of Roger Collinge

For your attention!

Replacing paper share certificates

This step, known as dematerialisation, is not required by the EU for some years, but there may be advantages for us if it is implemented sooner. Last January, I gave further information about the "direct record model" that is being proposed from within the industry to replace share certificates, first reported to members in July 2013. Now the finalised Industry Working Group paper on a viable model for dematerialisation in the UK and Ireland is available, explaining how this will work if it were to be adopted by the government. Members may obtain an emailed copy free of charge from Elizabeth Baxter, or a printed copy on payment of £5 to cover our costs.

Aero Inventory

Members will know that I cavil from time to time about the fact that when public companies hit the buffers and we lose money we almost never get to know what happened. Well in this case there may be some satisfaction in knowing (albeit long after the event) that the Deloitte Partner concerned and the then finance director have been censured by the FRC. Or, given that that is all we get to know, perhaps not.

Northern Rock

On the other hand the news that Northern Rock is now 'perfectly solvent' may give some encouragement to those battling to try to secure retrospective justice for its creditors—but least our own director Brian Peart. Carry on the good fight!

Bill Johnston

How do we access risk?

by Malcolm Howard, FCMA

A key question for investors is how we assess risk. According to academics, risk is measured by a share's volatility. However, seasoned investors know this is absolute nonsense; the only significant risk we face is that the company we have invested in runs out of money.

In the early 1980's it was recognised that large chunks of our industries, such as car making and steel, were at the point of collapse. We had to invent new innovative industries if we were to survive. The problem was the 'equity gap'; small innovative companies could not finance growth because they were deemed by the banks to be too small and therefore too risky. The solution was 'venture capital' and in 1982 the 'British Venture Capital Association' was formed. The problem was that venture capitalists needed a way to offload their successful investments. The companies they invested in were too small to float on the main market (hence the 'Equity Gap'), so a new market the 'Unlisted Securities Market' (USM) was formed to provide an outlet. But investors did not show much appetite for this market and it collapsed. It was replaced by the 'Alternative Investment Market' (AIM) and investors were given a number of tax incentives, so it would not suffer the same fate as the USM.

Clearly those companies listed on AIM were riskier than those listed on the main market, but they were not as risky as start-ups. So the government came up with the Enterprise Investment Scheme (EIS) to cater for these very high risk companies. Anyone investing in qualifying EIS companies can get tax relief, with an overall investment limit of £1 million, spread over several years. This tax relief was still available when EIS companies moved over to AIM. Also, in many cases, investors holding shares in AIM companies can exempt any capital gains they make from Inheritance tax. In must be noted, however, that the tax rules relating to EIS and AIM are complex and anyone investing in these companies for the purpose of reducing their tax liabilities should seek professional advice.

Now, with all these tax reliefs flying around, it must be obvious that investing in AIM companies, especially those who started out under the EI scheme, is relatively high risk. Quite often these companies are over-valued primarily because of the way they are set up. For example, two entrepreneurs each invest £1,000 buying 1,000 shares of £1 each, split them into 1 million shares of 0.1p each. The company's sponsors then weigh in by paying 0.9 pence per share and the general public think they are getting a bargain at the offer price of 1.5p. There is nothing illegal in this; it will all be shown in the Prospectus.

So, even after tax relief (which the entrepreneurs don't get) the general public can end up paying a significant premium.

What this means is that AIM companies can be more volatile that those listed on the main market. When things go wrong, the price can collapse very quickly. Companies listed on AIM are subject to far less regulation than those on the main market; investors holding shares in companies listed on AIM need to be vigilant. The main things to look at for are, any one of which could signify bad news:

- cash inflow from operating activities being lower than operating profit;
- debtor days being higher than they should be;

inventory days being higher than they should be.

Debtor days are calculated as debtors divided by sales x 365. For interim accounts the formula is debtors divided by (sales x2) x 365. It is a concern if debtor days exceed 90 days, or can be seen to be increasing over time.

Inventory days are calculated as inventory divided by cost of sales x 365. Again, cost of sales is multiplied by 2 for half-year accounts to annualise them. It is a concern if inventory days exceed 60 days, or have increased over time. However, this rule does not apply to house builders as their land purchases are counted as inventory.

I visited a presentation from an AIM company in the middle of December. Their presentation showed debtor days significantly increasing and they admitted their main division (of four) would likely show a downturn in 2015, although they were confident their other three divisions would grow. At the time of the presentation their shares were trading at above £7; one month later they were trading below £3.

At the November 2013 meeting on the London & South East Group, a member read out ten AIM companies taken from Company Refs. As an experiment, the share prices of these companies have been tracked monthly. An imaginary £5,000 was invested in each company. I reviewed three of these ten companies (shown in bold) and discounted each one for the reason given. The results are shown on the following page. At the start of the experiment the FTSE 100 stood at 6,687.4 and at 14 January 2015 was down to 6,406.7, so anyone investing £50,000 in a FTSE tracker would have lost £2,099 over the same period. But for Blinkx plc, these AIM companies would have done better. So the moral is; by all means invest in AIM companies, but be vigilant.

	Price (p) at 11/11/13	Price (p) at 14/1/15	Gain (loss) (£)
GVC Holdings	350	476	1,764
Dart Group	223	285	1,395
Cohort plc	207	234	648
Clinigen Group	502	507	53
Bond International	93	91	(93)
KBC Adv. Tech.	98	95	(150)
Fairpoint Group (debtors?)	**134**	**114**	**(759)**
Northbridge IS (over-valued)	**469**	**392**	**(847)**
Statpro Group (accounts doubt)	**93**	**74**	**(998)**
Blinkx plc	**207**	**26**	**(4,332)**
Overall			**3,319**

Now, for a risk that many readers will not be aware of. For accounting purposes, leases are divided into two categories; financial leases and operating leases. A financial lease is where the lessee owns the asset at the end of the lease. In such cases, what amounts to 'rent' is treated as interest and the fair value of the lease (both asset and liability) is shown in the Balance Sheet. As each annual instalment of the lease is paid it can be seen that the fair value of the asset will exceed the fair value of the liability.

An operating lease is where the lessee does not own the asset at the end of the lease. In such cases, the annual cost of the lease is shown as 'rent' in the Income Statement and nothing is shown in the Balance Sheet. The problem with this is that companies with operating leases can have huge liabilities (paying the rent for an agreed number of years), but hidden.

The International Accounting Standards Board has recognised this problem; they intend to amend the standard dealing with leases. The concept is to treat operating leases the same was as financial leases. Rent would still be shown in the Income Statement, but the 'fair value' of lease, both asset and liability, would now appear in the Balance Sheet. However, because the lessee never owns the asset at the end of the lease, the fair value of the asset (the price at which the lease can be sold on) will likely be much lower than the fair value of the liability. It will be obvious that companies with operating leases (retailers, hotels and airlines) are not looking forward to the standard being changed.

With regard to operating leases, at the end of the lease both the asset and liability will disappear, so strong companies have nothing to fear. However, this revision will highlight weak companies; in such cases the share price is bound to fall. The recommendation is that if you hold shares in any of the above industries you establish what percentage of a particular company's assets are owned. Those with a high level of leases will be seen to be high risk in the event of an economic downturn as their Balance Sheet will look weak.

Malcolm Howard

North-East Region

I have taken over as Secretary in this Region. My appointment has encompassed the visits to *Marstons* the brewery in September and *Cranswick* the food company in October. Both were enjoyable and enlightening.

Now here is an invitation to revisit a highly respected structural steel company based in Severs House, Dalton Airfield Industrial Estate, Dalton, Thirsk, North Yorkshire YO7 3JN. We´re talking of course of *Severfield* which operates on an international scale and is a market leader in structural steel production and also delivers a variety of services including design, manufacturing, construction and contract management. The company has been involved in many of the most iconic structures in the country such as the Shard, the 2012 Olympic Stadium, the 02 Arena, Heathrow Terminal 5, the Thameslink Borough Viaduc Bridges, the First Direct Arena in Leeds and the Baltic Millennium Bridge in Gateshead.

Presently Severfield enjoys a strong balance sheet and is benefitting from an operational and cost improvement programme aimed at increasing operating margins.

On Wednesday 4th February Alan Dunsmore - Finance Director - has kindly agreed to make a financial analyst type presentation to us followed by a tour of the factory. This will be, I am sure a very interesting visit. For those attending I need to be advised of shoe and 'high viz' vest sizes. For the latter there is a choice of S, M, L and XL. I am looking forward to a first-class visit. Obviously, the numbers we can handle is limited and I would like to hear as soon as possible from members wishing to attend.

Julian Mole
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A Victory for the Little Man (and Woman)

A report by Eric Chalker, Policy Director

Among the Chancellor's announcements in his Autumn Statement last month was a small revolution that has largely passed the media by. Takeovers by schemes of arrangement will no longer avoid the payment of stamp duty on the shares being acquired. We immediately welcomed this news on the UKSA website.

This stamp duty avoidance is an anomaly against which I have long protested, in private and public, writing to my MP when I first learned of it in 2009, frequently highlighting it as one of the reasons shares held in nominee accounts have been purchased without their owners' consent and bringing it to the authorities' attention whenever I could. The government's response to my MP, six years ago, was that EU rules prohibited it from doing anything. Last year, sitting with an interested Treasury official in the FCA committee examining nominee account issues, gave me another chance to highlight the issue and perhaps that was the tipping point.

The government has decided to remove the option of cancelling a company's existing shares when it is taken over; it has been this which enabled the avoidance of stamp duty, because the new shares issued in exchange cannot be taxed. Takeovers by schemes of arrangement will still be possible, but they will now be a less attractive option and indeed, there is a view in the City this will make contractual offers more likely. That is, I think, a victory for those holding shares in pooled nominee accounts.

Why is it a victory for us?

A takeover by scheme of arrangement deprives investors holding shares in nominee accounts of any right to participate in the decision. These takeovers are decided by <u>*vote*</u> and private investors in nominee accounts do not have the right to vote, even when the future of their investments is at stake. UKSA has long seen this as scandalous, not least because investors face so much pressure to use nominee accounts, which may even be voted without their knowledge in favour of a scheme of which the City approves but they do not.

A takeover by scheme of arrangement gives an acquirer 100 per cent of the shares regardless of how many shares have been voted. The High Court gives no protection to those excluded from the vote, because it is bound by precedent to ignore the degree of participation. The Takeover Panel gives no protection either, despite its "*central objective (being) to ensure fair treatment for all*", because it loftily ignores those who are not on the share register even though their interests are just as much at stake as any other investor's.

Would-be acquirers love the arrangement, because they buy companies cheaply – now slightly less cheaply than before but still not equitable. Such takeovers will not be equitable until all nominee account users are fully enfranchised. Even so, UKSA welcomes the Chancellor's announcement because we believe it will result in fewer takeovers by this method, with a shift to contractual takeovers instead where every beneficial owner has to be given the chance individually to accept or reject what is offered for his or her shares.

Further information can be found at https://www.gov.uk/government/publications/companies-act-2006-restricting-share-capital-reductions-in-takeovers-draft-statutory-instrument.

Resisting City bias

Leading up to the Chancellor's statement on 3 December 2014, we were asked to comment on an internal government paper "options for change". Up to that point, none of the opinions canvassed had been representative of those who put their own money into company shares, so I was not surprised to see what I described as the "City bias" of the views expressed.

They reflected a general presumption that once directors have recommended a takeover it must be a good thing. That recommendation may be based on nothing but a third party's "independent" valuation of the offer price, but the value of a company's shares will always be a subjective matter or there would not be a stock market, so these "independent" valuations are little better than a tip sheet and camouflage for whatever may be the real reasons for the directors' recommendations. But – and it's a big but – the advantage seen by the directors may well be to the *dis*advantage of a significant body of shareholders, who may even feel cheated by a process that can, to some, seem sneaky and underhand, depriving them of future value.

The simple fact is, use of a scheme of arrangement makes it *easier* for an acquirer to obtain 100 per cent control. The true meaning of "easier" in this context is *cheaper*. Almost invariably, to obtain 90 per cent of a company's shares voluntarily (and then legally 'squeeze out' the remaining 10 per cent), a would-be acquirer would have to offer and pay more than by using a scheme of arrangement.

Of course, City institutions are likely to gain more from the use of schemes of arrangement. Due process must be followed, involving accountants, lawyers and, of course, a valuer. When so many good people have spent so much effort on the case, how can any reasonable person object to the proposal?

One company chairman, in 2013, when he was faced with a blocking vote, even went so far as to threaten (surely with questionable legality) to adjourn the meeting in order to flush out additional proxy votes in favour if the objector did not cave in, so the objector did, despite an unsatisfactory price being offered.

We have urged the government not to give in to City pressure to resile from or weaken its intention. As the government has noted, "considerable opposition" is to be expected from those whose commercial interests are threatened by any interference with current practice. Private investors, who lack the resources to match professional lobbying, are often adversely affected by the financial services industry upon which they are inevitably, at least to some extent, dependent and must trust the government not to succumb to self-serving special interests.

What now?

The draft statutory instrument to amend the relevant Companies Act regulations has been laid before Parliament. We must hope it will be approved. But that will just be a first small step to improving the position of nominee account users, because takeovers by schemes of arrangement will still be possible. The government has acknowledged this, in the following paragraphs taken from the letter I received from the Department for Business Innovation and Skills (BIS) after our contribution to its "options for change" paper had been submitted.

Some stakeholders commented on the position of individual shareholders in schemes of arrangement, arguing reform was also need to address issues such as the lower threshold for squeeze out of minority shareholders in schemes compared to contractual offers, and the perceived difficulty for individuals holding via nominee accounts to secure effective proxy representation at Court hearings. They argued that that this measure does not go far enough to address their concerns over the usage of schemes.

We have not sought to address these points in the regulations laid today because the government has been clear from the outset that the objective of this particular measure is limited purely to achieving a consistency of stamp tax treatment. The points raised have however been noted and we will consider them further in the context of our wider work on individual shareholder rights.

UKSA welcomes this commitment and will continue to assist BIS in the work it has undertaken.

Eric Chalker

High pay, but questionable performance

Peter Parry

As John Hunter has reported, we have a new volunteer to assist with policy matters, Peter Parry, BA, MBA, Dip Inst M, MCIPS. Peter, a member of UKSA since 2008, has spent much of his career in management consultancy specialising in purchasing. He has been investing for over forty-five years and has a portfolio of about 100 different holdings. He readily admits that this might be too many and that he should rationalise the portfolio. He says: *"I find it impossible to keep up to date with every holding. Yes, risk is well diversified but with this number of holdings I might almost as well be invested in two or three well managed funds."*

Peter's particular interest is in boardroom pay. This began in the mid-1990s when he was contacted by the BBC's Newsnight programme and, as a private shareholder with shares in WPP, asked to comment on the multi-million pound bonus being paid to the Chief Executive, Martin Sorrell (now Sir Martin Sorrell). Peter adds, *"Over the years I have attended many shareholder meetings and often raised questions about directors' pay. The responses vary from bland and vague comments about needing to retain high-calibre people, to disdain at the sheer impertinence of daring to ask about an individual director's pay. In one case, after about ten minutes of pushing for satisfactory answers, they simply lied to me to shut me up! When that happens you know that the company's shares are better avoided."*

There have been many expressions of opinion emanating from UKSA over the years on directors' pay, but it has long been apparent to me that we lack a coherent, comprehensive policy on all aspects of remuneration. The problem, of course, is that there are so many aspects of this, which is largely the reason why the pay project I announced in 2013 has yet to get off the ground. However, with Peter's help we can begin to remedy this, starting with one particular aspect, which is the relationship between pay and performance.

Peter and I have agreed terms of reference for this project, which will begin with a study by him of what has already been published on the subject. After that, Peter expects to look in detail at individual companies. When he gets to that stage, there is likely to be scope for other members to assist him, so if that is something that might interest you, do let me know.

Eric Chalker, Policy Director

What are the investment prospects for 2015?

2014 was one for many of the toughest years apart from 2001 (9/11) and the financial crisis years. Depending upon how closely you follow the markets, maybe you're under the vague impression that 2014 was a reasonably good year . If so, you're very wrong, at east when it comes to the London. Perhaps you were thinking of Wall Street's S&P 500 which was recording new highs for the S&P almost every week. But often each was only a fraction above the previous new high. Even so, the index had a pretty good year, up 11.8% (14.5% including dividends).

But it was only the eighth-best performer out of all international markets, beaten by Thailand, Qatar, Turkey, India, Philippines, Indonesia and of course (you knew that didn't you) Egypt, the global leader (up more than 30%.

The London stockmarket fared *much* worse than the S&P 500. Even our flagship index, the FTSE 100, was down 2.7% in 2014. However compared to smaller companies, the Footsie was on fire. AIM stocks had their worst year since the financial crisis. The FTSE AIM All-Share index crashed 17.5% while the FTSE SmallCap (which covers smaller Official List shares) fell 4.9%. If you think that's bad, it looked even worse three months ago, as there was a minor recovery towards the year end. In mid-September, the AIM index had plunged more than 20%, while the FTSE SmallCap was down 11.1%.

Still, let's be grateful for small mercies. London wasn't anywhere near the worst performer of 2014. The butcher´s bill ranged from South Korea (down just over 10%) through Chile, Poland, Brazil, Columbia, Norway, Hungary, Austria, Portugal… and finally to the worst market of all: Russia –down 40%.

This year the warnings come thick and fast - an undeniable slow-down in China, monetary tightening in the United States, deflation in the Eurozone, you name it - trouble all along the line. No wonder than that the Santa Claus rally didn´t happen. Alas, since the old boy vanished into the North Pole for another year the market has been unabashedly sprightly. By the time you read this, Greece may have a new government and gritted teeth in Frankfurt will indicate that as quantitative easing has made a belated appearance.

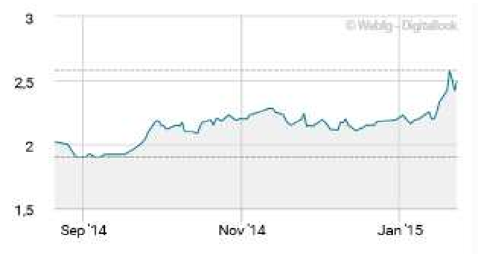
Frankly, if you´re looking for the definitive wisdom of the ages to come from me, you´ll be in for a disappointment. But raising share prices are better than falling ones and I am not disposed to dump good stocks on abstract grounds. Good luck is the message of our new Chairman. Amen to that.

Bill Johnston

An UKSA Christmas Treat

For over a decade South West members have met for a Christmas feast at which there is an annual award for the best SW forecaster.

Each year Dr Ted Moss asks members to forecast key where key financial indices will be in a year's time. He donates a bottle of fine wine for the winner. The first year, over a DECADE AGO, Ted won it, and guess what this year, his wife, Dr Catherine Moss, was the winner.



NAHL 6-month share-price graph

Before this the highlight of the day was the morning presentation by NAHL PLC a recently-floated AIM company focused on the UK personal-injury market. It is quite likely that during a life time most of us will suffer 3 or 4 injuries which may lead to claims.

These face to face meetings are the very essence of the UKSA offering and the members present, in thanking the speakers, expressed the importance/wisdom of meeting the key people when seeking to make wise investment decisions.

Incidentally, there is room in this particular inn. The event is open to all UKSA members and their partners and friends. The King´s Arms provides us with an excellent lunch accompanied by first-class wines for the £25 fee which UKSA South-West charges to participants. It is my sincere hope that some of my fellow members will make the journey down this year - I doubt that you would regret it.

Peter T. Wilson

Letters to the Editor

Dear Sir,

I am writing on the subject of "break fees" or "termination fees" which are payable in certain corporate transactions if one side or the other pulls out of the deal for reasons specified in the contract. Examples might be if the Vendor, after signing the contract, receives a better offer from some third party, or if the Purchaser cannot obtain any necessary licences or consents (eg from competition authorities) to allow the deal to go through.

Thirty years ago break fees were unheard of this side of the Atlantic. Then they crossed the water and became common both in public takeovers and private deals. Initially the Takeover Panel allowed such arrangements for public deals (within certain limits): then a few years ago they banned them (with one minor exception). The reason, no doubt, for banning them was that such arrangements were not thought to be in the interests of shareholders (whose protection is the key objective of the Takeover Code).

The Takeover Panel, however, in general has no jurisdiction over private deals ie deals where one company sells a subsidiary, or a business, to another company, even if Vendor and Purchaser are both listed.

It now seems to be common practice for fees of this type to be payable in many (perhaps most) private deals. Two examples have hit my desk in the last few months: the disposal by Standard Life of its Canadian business and the transaction between GlaxoSmithKline and Novartis, the circular for which was issued a week or two ago.

Both Standard Life and GlaxoSmithKline are UK listed companies and, because of the size of the transactions, the Listing Rules required them to be conditional upon approval by their respective shareholders at general meetings. And in both cases, if the shareholders of the UK company did not approve the transaction, that company would, under the contract, be required to pay termination fees to the other party, the equivalent of £55,000,000 (yes, that's right, fifty-five million pounds sterling) in the Standard Life case, and US $900,000,000 in the GSK case (yes that's nearly one billion dollars – enough to [insert your own pet project for the third world] and no doubt have a few cents left over).

The figures are enormous, of course, but that is not the main reason for my writing. The reason is that in providing for break fees in such circumstances the board of the UK listed company is, in effect, pointing a pistol at its shareholders and saying to them "If you dare vote against this deal, you company will be worse off to the tune of [insert a very large figure]". In other words the board is more or less forcing its shareholders to approve the deal – hardly a free vote, I would have thought. I would be less worried if the break fees were the subject of a separate (not inter-conditional) resolution of shareholders, but of course they are not.

I wonder if others feel as I do about these arrangements? And if so, what do we do about it?

Richard F. Wheen

Dear Sir,

Members were recently asked for their views on the reporting standards of smaller firms.

I do not invest in smaller firms so my response must be anecdotal. If I did invest in smaller firms I would require them to give me all the information I needed to take a full, proper and considered view as to their prospects. I would not risk my money in a dark hole. From what I hear some such (plus Tesco) cover themselves in a thick fog of obscurity. Is this to cover hidden secrets, out of incompetence or a failure to pay advisers enough to tell them and their investors the truth – or if told the truth the advisers would be sacked?

HMG will legitimately have views on this but lacks the resources to police the small fry. The sanction lies with potential investors. Inadequate information should mean no investment, but some fools are easily parted with their money. How far should they be protected?

Martin Morton

Dear Sir,

I often get asked about dealing with certificates so I thought the following might be helpful.

My wife and I own certificates jointly. We use Jarvis Securities. Flat rate charge of £19.50. Deal by making a phone call, buy on 3 days (maybe 2 now) with debit card; sell on 10 days as certificate needs to get there for deal to complete. Certificate not an issue when buying as it trundles along about 2 weeks later. Contract note sent online and usually arrives just after deal completed. Generally a quicker process than dealing online.

Name on register is the important bit; the certificate is a bit of a nuisance.

Nick Steiner

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 8680 5872 or email harrycb@gmail.com

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 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 or Julian Mole at julian.mole@btinternet.com

NORTH-WEST & NORTH WALES

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

Regulators and Remuneration

A thoughtful article by Paul Jackson in the Investors Chronicle brings up a key example of the law of unintended consequences. What he´s talking about is the bankers´ bonus culture which, especially since the banks were bailed out wholesale, has damaged the public perception of business life more than the next five factors combined.

So, it seems that everyone should support the forthcoming EU bonus cap. Obvious, isn´t it? And obvious too that the greed and stupidity of the bankers would lead to an immediate lobbying that this restraint on what they regard as their due desserts should not be imposed.

But wait a bit. You can cut or not pay bonuses but you can´t really do that with salaries. And the banks have cut the bonus element of the remuneration package - and upped salaries. You can´t win - and bankers, it seems, cannot lose.

Bill Johnston

The Royal Mail IPO and Lord Myners

The UK Shareholders' Association comments:

Vince Cable

Lord Myners' conclusions from his investigation of the initial public offering of Royal Mail shares in the autumn of 2013 have now been published. The Business Secretary, Vince Cable, wanted to know whether the government had been misled over the initial price of the shares by relying on the pre-launch promises of City institutions, known as a book-building process.

By putting itself into the hands of the City, the government should not have been surprised that it was subjected to City practices. For too many City institutions, an IPO is a chance to make a quick buck, not an opportunity to invest long term in a business.

Lord Myners

A book-building process inevitably excludes ordinary individuals with their own money to invest who might be expected to have long term interest in the company. Setting an initial limit of £10,000 per investor was further discouragement. Settling at a limit of just 227 shares per applicant was contemptuous. Private investors were left to buy more shares at a higher price in the market, or sell their tiny holdings and thus deprive the company of long term investors. How sad.

Will Morgan Stanley, newly-announced agent of the government, be making Lloyds Banking Group shares directly available to private individuals, or must we once again buy them only after others have profited by trading them?

Long, long gone are the days when the issuing house had to take full page advertisements, one in the Financial Times and one in the Times, the Telegraph, or whatever to ensure the private investor got fair crack of the whip. AS our Chairman says ´Scandalously, the decision to allot no shares at all to private applicants for more than 10,000 shares could not have been more effective in excluding significant private investors from the register had it been designed to do so. Perhaps it was.´

Writing on the matter in the Investors Chronicle Stephen Wilmott has noted that in Australia a hybrid system with an open book-building process has developed - and our sister organization in Australia is one of the strongest in the world. Go figure.

Bill Johnston