House of Commons Treasury Committee

Future of Financial Services Enquiry

RESPONSE FROM:

Martin White

19th February 2021

Future of Financial Services

To: House of Commons Treasury Committee

Contents

1. Main points

1. I recommend that decisions about how the UK financial services sector should be regulated should not be made without first considering the impact of the financial services sector on society as a whole. The behaviour of the financial sector not only influences the financial outcomes from retail savings, but it also influences the behaviour and culture within businesses as a whole. Problems of short-termism, under-investment in future competitiveness, bonus culture, executive greed, all could be argued to originate within the way in which the financial sector operates.

2. I would distinguish between components of the financial services sector. The problems outlined above relate essentially to what ought to be a stewardship role: the advice and investment management chain. This is characterised by poor consumer outcomes relating to the limited understanding of consumers of the impact of expenses. The consequences for the public are disastrous; their wealth is effectively extracted over time by the explicit and implicit expenses involved in most retail products and services. Yet for those who know how to avoid these expensive routes, vastly better outcomes can be achieved. But the financial sector, left to its own devices, will never broadcast the essential truths or the good value solutions that do exist. It is from these essentially avoidable expenses that the investment management chain is so profitable. I would challenge Parliament to confront this deep conflict of interest. Current and future generations of savers sadly tend not to realise until it is too late how badly they have been served by the system. Concern at this situation, which is not limited to the UK, is highlighted by the regular publication by the European organisation BetterFinance of their Real return[1] report on the outcomes for pension savings.

3. So for the advice and investment management chain, I believe that the whole thrust of legislation and regulation should be to put the interest of the customer first. A lawyer is expected to act solely in the interests of the client who relies on being told the full truth – why should the financial sector be completely different? In today's world, the huge profits of the financial sector arise because of information asymmetry. Arguably a deep injustice is in progress.

4. To tackle this problem of information asymmetry would not be impossible. In the recent "Call for Input" by the FCA on the consumer investments market, the Foreword to that report pointed out that there already exist "readily understood,

[1] https://betterfinance.eu/publication/booklet-pension-savings-the-real-return-2020-edition/

well-diversified, and low-cost investments", but that most people do not use them. It is, of course those consumers that have sufficient knowledge or appetite to work things out for themselves that use such products. Yet if the FCA were to publicise information about such products, it would be a simple matter for most people to use them. The consequences would be dramatic, both for consumer outcomes (good) and for the financial sector (less good).

5. In contrast with the advice and investment management chain, other parts of the financial sector, such as the pure protection products of life insurers, and general insurance products, operate in a genuinely price-competitive market. Admittedly, consumers that do not shop around every few years lose out compared to those that do, and regulatory attention is now rightly directed at this problem. But unlike the investment business, it is hard to make profits in general insurance, and the levels of international competition are high.

6. I also recommend extreme caution in interpreting all the messages you will receive from the financial sector lobby. The history of the financial sector does demonstrate the validity of the saying "knowledge is power". The marketing messages of the advice and investment chain are not aimed at educating customers. Essential truths, such as that active management in aggregate will underperform passive management, are suppressed, as is the power of compound interest on expenses.

7. One really concerning trend of recent years is the demise of individual shareholders, with a direct relationship with, and receiving communications directly from, the companies in which they invest. The use of nominee accounts has proved to be a disaster in this regard. Nominee accounts not only introduce an extra element of risk to the underlying owner (fraud at the nominee, for example), but also mean that there are fewer knowledgeable voices to challenge – or support – company managements. Of course, it suits the financial sector really nicely to push people into nominee accounts and into expensive funds. And lazy company managements may welcome the reduced challenge, and the reduced costs of maintaining the company register

8. This response only relates to a limited number of the 17 bulleted questions in your Committee's Call for Evidence. I would suggest that it is most relevant to the 12th question on wider public policy issues, and to the 15th question on consumer interests.

2. About the author

9. I am an actuary with experience in life insurance, pensions, and general insurance. I was one of the original members of the UK Shareholders Association when it was set up in 1992. The reason I joined USKA was to make use of my actuarial knowledge in the public interest. I make this submission on my own behalf with a public interest motivation rather than any particular interest group. I was the lead author of the joint UK Shareholders' Association / ShareSoc submission to the Financial Conduct Authority in response to its Call for Input on the Consumer Investments market.

10. It is important to emphasise that I am speaking for myself in this submission. I am not speaking on behalf of the actuarial profession or on behalf of any employer.

11. The motivation for this submission is twofold. First, to set out in strong terms the stark problem and consequences of the conflict between the ordinary consumer as saver and the financial sector. And second, to set out briefly the origin and thinking behind UKSA's Savers Take Control (STC) campaign, of which I am the architect. So this submission concludes with a brief discussion of STC.

3. Savers Take Control (STC)

12. As an investor in individual companies, over the years I developed an interest in how companies behaved, including the extent to which the management thought of themselves as stewards of the business and the well-being of their employees. I also began to understand the pressures that they were under from investment managers who were interested primarily in short term share price movement.

13. Over the years, I became more and more concerned that the way in which the financial sector operated was detrimental for the companies they invested in. Lord Paul Myners addressed an UKSA conference and explained how he had concluded, when managing the Gartmore investment house, that the business model of the investment sector mitigated against a proper active ownership role in the vast number of companies in which they held a significant share. He coined the term "ownerless corporations" to describe the problem.

14. John Kay spoke at another UKSA conference on his book "*the long and the short of it: a guide to finance and investment for normally intelligent people who aren't in the industry".*

15. As it happens, John Kay's body of work thoroughly covers the diagnosis of the problems which STC was devised to address. The Kay Review for the UK Government described the problems of short termism. The book "*other people's money*" describes how the City really works.

16. The problems are all inter-linked:-

17. The financial sector is able to help itself to consumers' wealth to a degree which consumers would be shocked if they really understood.[2] Unfortunately, to get a proper understanding, the principles of compound interest are essential.

---

[2] Quoting from a 2008 study by the Royal Society of Arts, which can be found at https://www.thersa.org/reports/tomorrows-investor-report "The level of costs and charges also demonstrate the fundamental misalignment of interests between ordinary savers and investment professionals. Long-term savers will commonly find themselves paying out 40 per cent of an investment over its lifetime in fees (a figure equivalent to roughly ten years of contributions). Fees have risen dramatically in recent years, doubling in unit trusts for example. Yet performance has not followed suit. People are paying more for less. Yet the RSA's research shows that not only are investors unaware of the scale of charges they are paying, but that they are shocked when they do find out. This is a shocking sign of investor disenfranchisement."

18. The well-paid financial sector cannot act as police to executive pay in its investee companies, nor can it act to discourage executive pay regimes which encourage short-termism and cause a loss of public trust in business. A short-termism in business is not in the interest of the UK as a whole; we depend on continual improvement of our industrial capabilities of all of our business and the development of the people who work in them in order to make our way in the world.

19. Within Parliament there is considerable interest in vital questions such as international competitiveness of our people, in the importance of retaining strategically important businesses in the UK, and of course on the environmental concerns that will impact future generations. I believe that an approach to stewarding business is needed that encourages long term ownership and focuses less on short term share price movements as the measure of success. But such an approach cannot be devised quickly – it needs deep thought to avoid failure through unintended consequences. And listening to the financial sector lobby is not going to help.

20. However, the real power today is in the financial sector. Its lobbying power over Parliament is considerable. The chances of Parliament attacking the problems of short termism, executive pay, the lot of consumers, etc. is something not to be left to chance.

21. So I have slowly concluded that the only way to change the system, and it would be a long and difficult road, was to change consumer behaviour, by consumers helping each other to make sensible choices over their finances – taking power at the grass roots, as it were. I prefer the term "empowerment" to "education". Part of the message is that the fundamental purpose of business is to serve society, with sustainable profits as a consequence of doing this well. The title "savers take control" was chosen over "investors take control" because the term "savers" sends a more inclusive signal. And for credibility, the whole thing needed to be completely charitably motivated, with knowledgeable volunteers who are no longer conflicted in relation to either the financial sector or the executive pay regime.

22. I have provided links to UKSA's STC[3] pages and to the response[4] to the FCA's Call for Input in the footnotes below.

---

[3] https://www.uksa.org.uk/Savers_Take_Control

[4] https://www.uksa.org.uk/news/2021/01/30/our-response-fca-consumers-need-work-together-because-fcas-plans-do-not-put