

Lord Myners speech

Thank you Anne. I am not entirely sure what a responder should do, whether they should pick apart the arguments or congratulate the speaker. Suffice to say that much of what Anne has said today is on common ground with what I've been saying and trying to do now for over fifteen years. I produced my first report for the DTI in 1995 when Michael Heseltine was President of the Board of Trade, as he then titled himself, on the issues of ownership which I think is the core unaddressed issue. But the new Stewardship Code, I think, is a big step in the right direction. When introduced I tend to be described as somebody who has made it his role to upset people by expressing views on governance and ownership. Interestingly nearly everybody I speak to in the industry shares my views, some of them would rather I didn't threaten their rice bowl by encouraging too much debate but they say, "You are right, it's just rather uncomfortable and we are not sure how we should change things." If I look back at the report I produced for the Treasury on institutional investment in 2001, at the time it was regarded by the FT and others as being quite a fundamental change in the model of management of institutional funds. It's now absolutely in the main stream of conventional thinking and practice: the rejection of the balanced mandate, the need for more professionalism and a business-like approach by trustees, the need to have a risk budget, the need to query cost and expenses, the need to be clearer about conflicts of interests and their management. I think these are now in the rubric and protocol of all good management models.

Fair Pensions is a wonderful organization, anything that has Catherine leading it and Jon supporting it is bound to be successful and I encourage them with all my heart to pursue with their passion and objectivity the goals that are set out here. We need a more responsible, accountable, transparent and democratic investment process. There is too much vacuum, there's too much agency intervention in the process which means rent is being taken from the investment process at the cost of returns for the principles. And the principles, the ultimate beneficiaries, the ultimate risk takers, are too distant from what is being done with their money. The FairPensions mission statement here talks about shareholder power. Shareholders do have power, they have *de jure* power, they have a lot of *de jure* power in this country probably more than any other jurisdiction in the world. In terms of the rights we have as described by Anne, *de facto* they have almost no power at all. I've coined the phrase the ownerless cooperation which I think correctly described public companies where the distribution of ownership is so wide that no one owner really speaks with any effective voice. Most big investors are not only invested in company A but also in company B, company C, company D, with whom it competes, to whom it supplies and from whom it draws services.

Who are the owners? Well in my view there is no doubt about it, the ultimate owner is at the beginning of the chain. It's the trustee of the pension fund, it's the trustee of the endowment. The fund managers are not the owners. I do not find great fault with fund managers, I think fund managers are rather good at responding to the incentive effects they are given, they are simply not required to think and behave like rational owners as an economic text would suggest. Capitalism requires owners. We have major companies who do not have owners. We have multiple tiers of agents between the owner and the

company and the executives of the company. Those agents behave rationally but they can put their own objectives and purposes ahead of the clients. As I say, they take excessive fees and rent out of the system. Anne talked about how the pressure on investment, on investment returns, is intense yet it seems extraordinary to me that most principles rarely challenge the fees that they pay. Aggregate fees for fund management have increased in the last 10 years even though returns have fallen. In an environment of low return which would be consistent with a low return for the risk free rate, the rent, the bite that is being taken out of returns by agent fees becomes increasingly large.

Why are we where we are? Well, Anne described diversified portfolios meaning small holdings and fragmented power and I think this is the core of the question. We accept this highly diversified model as being the rational position to be in and it's duplicated, replicated and applied across the world. I question whether this is a good model. I question whether this is a model which in the end ensures that there is no accountability, there is no owner, because ownership is so widely diversified. In academia, Bill Sharpe tells you that portfolios don't need to be anything like as diversified as they are. The only way we can fundamentally change the system and have investors who behave like owners is to move to a model which measures performance over longer time horizons and involves less diversified portfolios. In the words of the industry professional, more emphasis on alpha but over a long period of time; less emphasis on beta, higher intermediate tracking error.

Why am I the lone voice, or almost the lone voice in this? Because the whole model, the whole industry around pension fund management is based around the current model of high levels of activity and broadly diversified portfolios. This suits down to the ground the agents. In my view this is not a good outcome for the principles. Unless we change that model I think we are whistling in the dark if we ever think that people who own shares can become owners of companies. They simply won't, there are too many agents in between; they have too weak a voice because of the diversification of ownership.

In that case, who are the real owners? Well, some would argue that the real power now lies with the executives. We've gone from the vision of the left of wanting to control the commanding heights of productivity to a situation where effectively the people do have that, they have it through their insurance policies, their savings schemes, through their pension schemes but actually we cannot give affect to it because of this model of broadly diversified portfolios and the insertion of too many agents between the owner and the ultimate company. The real power now probably lies with the non-executives. I share a view with Anne, and I think we would be wrong to emphasize independence as an important test for non-executives, we should be emphasizing competence. I am increasingly persuaded that independent directors should be close to full time, not full time necessarily in one company but they should actually become professional non-executives and should probably do that at an earlier stage in their careers than has been the practice in the past. Anne talked about board effectiveness and evaluation and her experiences parallel mine very closely. My observations from looking at the work of the failed banks which the Treasury Select Committee and others have done, is there was an appalling failure of governance at the heart of those banks. Those banks were brought

down by bad management, bad understanding of risk, bad risk management policies and mitigation strategies and poor credit decisions. The boards were failing. What I ask here is what did the owners of these banks do, they didn't get engaged at all. The owners of the banks really were quite supine, they tried to challenge in one or two cases but clearly failed and importantly they seem to have learnt, to have felt obliged to learn, no lessons as a result of this failure. The institution has not said, as far as I'm aware, 'my god we bogged up there and we are going to do things differently.' I think, for instance, institutional investors should be a powerful force for board effectiveness reviews. This is the heart of ensuring that you don't get disastrous outcomes, that you don't get extreme tail risk, and yet most institutional investors show no interest at all in board effectiveness reviews. It's a subject that is done on a tick box basis. They need to be like the Walter Badger view of the sovereign in the British constitution which I think was to encourage, to advise and to warn. That's the role that the institutions should have as effective shareholders. They are clearly not doing it, there is no incentive for them to do it because their clients have not asked them to do it because it is not compatible with the investment model and the investment objectives.

Final points.

I would like to see more work here from academia. I think there is a complete disconnect in this country between academia and what is happening in this area. That is very disappointing.

The absence of power, something that is quite topical. Sir David Walker is apparently backing away from his recommendations on disclosure of banker remuneration. Three things there. His initial report said nothing about international comparability; it didn't say that 'my recommendation is subject to this being adopted throughout the world and this recommendation would not stand if it wasn't adopted internationally'. So this is quite a refined position that Sir David Walker, director of Morgan Stanley International, has now chosen to take. Secondly, I have regularly been told that there is a first mover disadvantage. Bankers say, 'we would like to reduce remuneration, we are fearful that if we move first our competitors will steal an advantage. That sounds quite logical, until you realize that the same firms own all the banks. The same institutions are big shareholders in Barclays, in HSBC, in Royal Bank of Scotland, in Citibank. Fidelity appears in all these share registers, as does Wellington, Vanguard, Henderson, and the Pru. So why are they not collectively writing to the banks now and saying that 'This is unacceptable, you as an industry have to do something to fix this'? We don't have a first mover disadvantage effect here.

The subject matter for this lecture was 'in the wake of the crisis'. I don't think we are in the wake of the crisis. I think we are still in the heart of the financial crisis and there are a great many signs, I'm afraid, that core issues have not been addressed. The will to secure trade changes has diminished; recidivism is reappearing.

Final, final observation, I would dearly like to see a return to mutuality and I believe there are some opportunities here. I was chairman of the Personal Accounts Delivery

Authority in its early form and Jeannie Drake took over from me. I would love PADA, or as it is now called NEST, to become a mutual. I would love the very large surplus that the tax payer now has from its banking interventions to be used to take first element risk in the establishment of new financial mutuals, in the savings, pensions and lending arena. I don't know if that constitutes a response or a second speech but I've probably lived up now to my reputation for being provocative. I do care passionately about these things but I could easily be wrong on several of them. Thank you very much.