Kepler Partners *Market Matters podcast* special edition with Baroness Ros Altmann

Jo Groves

Hello and welcome to this special edition of market matters. We're thrilled to be joined today by Baroness Ros Altmann, a renowned expert in both the investment Trust sector and the pensions industry. Having previously served as a UK Pensions Minister, Ros now sits in the House of Lords and is also a visiting professor at the London School of Economics. Ros, many thanks for joining us today.

Baroness Ros Altmann

Pleasure. Thank you for inviting me.

Jo Groves

By way of introduction, could you talk us through your background in both the public and the private sector and any challenges you might have faced along the way?

Baroness Ros Altmann

My main background educationally, and research wise, is as an economist. I did an economics undergraduate degree. Then I did a pHD Harvard and LSE on pensions, actually and social policy. And then I went into the City and managed pension fund money and institutional assets for many years, until I had my third child, at which point I retired from the City. I had a wonderful career doing mostly either international economic comparisons and macro work, currencies and bonds, or particularly equity fund management, which was very exciting at the time.

And once I had left, if you like, the full time City work, I set up a consultancy and I was very fortunate that I managed to do some really interesting projects for Government, for consumer groups, for industry groups and pension companies, as well as investment banks, so you know, it was fantastic.

That led on to work with Number 10 [Downing Street] and Number 11, and then I discovered some of the problems that were involved in the way consumers and pension scheme members were treated. And from a social justice perspective, I kind of took up the cudgels and started doing a lot of pro bono work trying to help when things were going wrong for ordinary people in terms of finance and try and put it right and that eventually basically led to me being asked to be business champion for older workers, for the government, and then ultimately Pensions Minister, for which I was put into the House of Lords.

But my main work has been trying to help people get better outcomes from the long term investments that they make, make policy work better for ordinary people, and try and help restore some of the balance in terms of investor rights, especially retail, but also institutional. As increasingly, one goes through and sees the imbalance of power between the very big companies and the ordinary shareholders.

Jo Groves

Thank you for talking us through a very interesting career indeed. And what in particular inspired you to become a public advocate for the investment trust sector?

Baroness Ros Altmann

Well, obviously I've known about the investment trust sector for a long time and it's always fascinated me that it was a bit like the poor relation to some extent, relative to originally what was unit trusts and then OEICs because I always felt that, as a long term investor - and my fund management style typically was, you know, looking for long term undervaluations where markets had mispriced or misunderstood things - it seemed to me a closed ended structure was actually very user friendly and especially at some points when investment trusts and markets were generally out of favour, they had fallen to discounts relative to the unit trusts that held pretty much the same thing. But of course, advisers ended up being paid lovely commissions for selling a unit trust and not the same rewards for recommending their clients by an investment company. So you know, I was long fascinated by that.

And then it was Baroness Sharon Balls who laid an amendment to legislation going through the financial services bill, who had picked up on this problem of cost disclosure for closed ended investment companies specifically in the UK - ironically, imposing supposedly EU derived rules on the UK markets, despite the fact that we had left the EU and despite the fact that EU countries themselves weren't imposing those rules in that way.

I ended up being persuaded that this really was one of those instances of market dysfunction, and if you like almost financial injustice, misinforming investors of the reality of what they were paying to have their money managed.

In the case of a closed ended company, they're not paying directly at all. It's the company that pays. So, I had my Private Members Bill, which went through the Lord's last session, but unfortunately fell at the general election, and Baroness Bowles has got one now, but it's got a bit waylaid in the Commons as well. So, that again got me much more closely involved.

And then speaking to the FCA, which originally when I did, I just thought, well, they haven't realised quite how this is all impacting the market, you know, telling people that holding a company costs them a huge amount of money in an environment where regulators were all saying you should look for low cost investments and the whole zeitgeist was about cutting cost was clearly going to drive people away from that particular type of investment, even though the investor wasn't paying what it was shown to them as if they were paying.

Addition to that, it had struck me that a closed ended fund structure was the ideal way for pension schemes - smaller ones, obviously the big ones have got their own departments looking at real assets. But for smaller ones who can't themselves invest in a wind farm and start running it or a range of wind farms or other infrastructure or real estate and property - they don't have the time or expertise - this was a way in which long term investors could sit there patiently, hopefully, having chosen the right portfolio, managed expertly on their behalf to invest in, and get the returns from that diversified ray of asset classes that I think most of us would think were ideal for long term pension investors, not just equities and bonds, but having, you know, other assets in the mix.

So, I thought having pointed it out to the FCA, that you know it was obvious that the massive increase in discounts and the huge selling pressure that had built up since 2021, was unlikely to be coincidental timing with the imposition of these cost disclosure rules upon closed ended funds, just because they wanted to try and make it look as if they could be compared with open-ended funds, which are a very different type of investment.

So, that's why I thought I needed to get involved, because the FCA clearly did not understand why this was wrong at the beginning, and indeed there was evidence to the select committees in the House of Commons, the Treasury Select Committee and in the Lords, which suggested that maybe the FCA was under the impression that investment trusts did charge you directly for holding their shares, which is absolutely not the case. So, it seemed to me that, you know, one really needed to keep on pursuing this agenda because what's really always been important to me is transparency.

You know, don't hide things from investors. The big problems that have arisen have often arisen because certain pieces of rather important information or relevant information were hidden away from the ordinary investor, and you know that could be in terms of hidden commission, it could be in terms of hidden charges that they didn't realise they were having to pay on top of other charges that they might have known about. So, having proper transparency for me meant not just telling people there's a cost or what the cost is, but also not misleading them about what numbers they are being shown, and what those numbers mean. And that was the big problem with the regime that the Treasury and the FCA finally said was not suitable at the back end of last year.

Jo Groves

Thank you. And coming back to the subject of discounts, as you just mentioned, as we know US hedge fund, Saba, has built substantial positions in a number of investment trusts. It's requisitioned EGMs to gain control of seven of these. As a long term supporter of the investment trust industry, what are your thoughts on the Saba proposals?

Baroness Ros Altmann

Well, you can't blame an opportunistic investor from taking advantage of what they perceive it to be an opportunity. And clearly what they have spotted is that the discount's very high. And probably not justifiably so. And sooner or later are likely to be corrected. On top of which, there are gaping holes in the protection for shareholders in our system, which allow an investor to come in with a minority stake and effectively take over control of the board without a controlling shareholding at all, acting in their own interests, not those of other shareholders, pursuing their own agenda and managing to just succeed by taking advantage of the lax protection regime that we have at the moment. On top of which, what became abundantly clear when listening to the Saba presentation, trying to explain why it believed its bids were in the best interests of everybody else.

Jo Groves

And it was quite memorable.

Baroness Ros Altmann

It was clear that they simply don't understand the nature of closed ended funds and patient capital, And maybe, you know, why should they? They're a hedge fund. They're short term traders. But if you wanted to be invested in a short term trading fund, you would not be in these kind of closed ended vehicles that invest in real assets and small companies and less liquid positions that you can't trade short term because they're not so marketable. And that seemed to be something that they have not understood, but interestingly, there was no mention of the market dysfunction partially created by the flawed cost disclosures rules that was also contributing to the selling pressure and the lack of buyers.

The number of investors, fund of fund managers for example, small pension schemes who've said they could no longer hold on to the investment trusts they kind of knew were really good value., because it ultimately would mean that the charges that they had to quote to investors were exaggerated to the extent that it would put people off the funds altogether.

So, although they knew that the value was there and some of them had kept on buying on the way down as discounts widened. Others were continuously selling, and that became one of those vicious circles which clearly these bids take advantage of. Because the discounts were anomalous. The market cost disclosure issue is, one way or another, going to be ameliorated and to the extent that that was driving selling, that will reverse. But that's the nature of cycles. You know, if you've been in these investment trusts for donkeys years or decades, shall I say, then you will have ridden through times when there were big discounts, and normally if you're an investor who believes in that investment approach or in the managers, you might well take that as a an opportunity to buy more of the company, because you're buying its portfolio at a fraction of its actual cost.

But the problem associated with that is that these companies couldn't raise any more money, and sometimes they had to engage in share buybacks. And, you know, the whole market was distorted to the extent that actually it's cost not only the shareholders potentially a lot of money, but also the British economy because you know, a lot of these companies are managing - very successfully by the way - some of the sustainable infrastructure and growth assets and technology companies both here and abroad, but a lot of them are here, that we need desperately to have more investment in.

Jo Groves

Thank you. Very interesting. And it was also interesting to see that shareholders very much came out in support of Herald's existing strategy at their EGM earlier this week. But in light of Saba targeting some of the more heavily discounted trusts, as you mentioned, do you think that boards should have been more focused on narrowing discounts to deliver value for shareholders?

Baroness Ros Altmann

I'm afraid I do. I think there has perhaps been a degree of complacency or people leaving it to others to try and point out that there was a problem here, which there clearly has been,. And, you know, initially it could have perhaps been blamed on macro factors and you know the sudden change in the interest rate environment perhaps, but that didn't last that long and that couldn't explain all the selling that was taking place. And when Baroness Bowles, myself and a whole group from the industry, have been banging away at trying to point out that, you know, there's an obvious anomaly that has been adding to the selling pressure, which could and should be urgently closed and reversed, we didn't really get the boards shouting and jumping up and down with us, which has been a bit disappointing.

I kind of understand it because, you know, if you've been managing these funds for many, many years, you have, as I say, been through this kind of cycle before. You've seen the discounts and you've seen them narrow again. If nothing else, maybe what's going to be learnt from the real shock of the Saba bids is that the boards need to take much more seriously the issue of discounts. They need to have better information from their shareholders about who's selling and why they're selling what, maybe they can try and do about it.

And I think there is also this real problem that retail platforms are not obliged - or don't feel obliged - to actually tell the investor in these companies what's going on, even when it is so seriously, potentially going to affect them. Now it's only been in the last few days, as far as I know, that some of the retail platforms have tried to be more proactive and reach out to the individual investors holding these 7 trusts. That's a bit late. It should have happened immediately. And/or if the platforms are not on the case trying to make sure that something as potentially damaging to shareholder interests as these bids might be is directly communicated to their customers, that there is another mechanism for the customers to be contacted directly by the company. But at the moment the company doesn't know who the shareholders are – they're nominees rather than shown as direct owners and it's the platforms that are the middle people here. And I think there is a real hole in investor protection that this can happen without anybody even knowing about it. There are going to be a number of retail investors who might never have known, and who still probably don't know, if they're away for a week or two.

Jo Groves

I'm coming back something you've touched on earlier. You've campaigned tirelessly for the lifting of cost disclosure requirements for investment trusts, with the double counting of costs certainly playing a role in deterring retail investors from looking at investment trusts. Could you talk us through your thoughts on the potential impact of these changes on the investment trust sector?

Baroness Ros Altmann

Well, if at last we can help people understand that there are some really important differences if you want to invest in an investment trust versus investing in an OEIC or a unit trust, and that those differences are not just encapsulated by looking at so-called OCF - what's called costs - then I think we will have moved forward significantly in the interests of the investment trust sector because if you keep telling investors that the OCF is a cost they bear when it's not - it's actually a company expense, just like Marks and Spencer's pay their managers, an investment trust pays its managers for doing, you know, fundamental work that reflects the company's performance.

But what is crucial to know, if you are comparing fund management costs or expenses between different types of investment, is the differences between the investment structure itself and the relevance of things like discounts or premiums. You know, what was happening was that retail platforms were actually barring investment trusts from being purchased on the basis that their supposed OCF, which is not an OCF. because it's not a direct consumer charge - of course there are fees to manage the portfolio, but they're borne by the company, not the investor – is a pretty crucial difference. So they were banning their customers from even buying them without saying well, yes, you know, the people managing this fund charge more than the people managing that unit trust. However, the investment trust is selling at a 20% discount, so even if there's a 1% differential in the management charges overall, you're still getting better value potentially and you need to understand that there are different mechanisms in place. There's gearing as well, which can magnify your returns - obviously it can magnify losses, but that's not why you would put your money in there if you didn't think it was going to do well for you.

Jo Groves

No, quite.

Baroness Ros Altmann

So I hope that where we would be heading, if we can get proper information out there is for the whole marketplace to stop comparing apples and pears and to help investors understand what relevant information they need to know about the investments that they either hold or might want to buy or sell. And that's not happening now and the cost disclosure has taken us completely down the wrong track and it's not been in the interests of investors, you know, transparency and consumer duty require information to be fully disclosed. But it needs to be clear, fair and not misleading. And that's where this is all fallen down.

Jo Groves

Talking of consumer duty, do you think that current regulations imposed by retail platforms to ensure that their investors make informed decisions is damaging the investment trust sector and if so, what changes would you like to see?

Baroness Ros Altmann

In my own mind, I have no doubt that the actions of the retail platforms have been hugely damaging to the interests of investment trust investors. When you look at the way in which these so-called charges were displayed and explained to investors, the investors were told that if the cost of managing a whole portfolio of different wind farms all around the country was something like 3% of the value of those assets, which in terms of managing real assets is not actually, you know, extortionate at all, but if you were told that every £100 that you put into that fund of a diversified array of wind farms would be worth £97 next year because of the 3% that the management was being paid by the company, you're not telling them the truth.

And if you then say they're not even allowed to buy that on your platform because it's too expensive, without telling them, for example, that it's at a 20% discount or 30% discount, or whatever it is, so in the end and if that discount reflects the true asset value, and typically the asset values of these companies have performed well, it's the share prices that have been the problem, then again, you're misleading the investor and you are denying retail investors the chance to buy what is potentially a good value investment, and the Saba bids have encapsulated the fact that someone from the outside has spotted there is good value here.

Jo Groves

Quite.

Baroness Ros Altmann

And so the retail platforms seem to have acted in their own interest, not putting the interest of their investors first. And the actions since the Treasury and the FCA put out their clarification, which said that OCFs should no longer be displayed in the way that they have been for so long, and that actually there is no ongoing direct cost of the consumer, and the platforms seem to have wilfully disregarded this and are not properly displaying, the correct information, and indeed, have now either threatened to or actually deplatformed those investment trusts that have tried to put what the Treasury and the FCA suggest would be more correct - that there is no comparable ongoing direct charge for the investment trust, even though there is for a unit trust - then you know the problem seems to be that the platforms, 1) would have to invest quite substantially potentially, I believe, in new systems to be able to cope with the correct information and 2) of course, there may be an element that platforms earning fees if their investors are holding open-ended companies, but they don't from investors holding ordinary shares, including investment trusts. So, you can see there is a conflict there for them, they'd be perhaps investing in something that isn't going to bring to bring them extra revenue. But on the other hand, if they are in contravention of consumer duty, which I am sure they must be, then further down the line there is going to be a cost to pay.

Jo Groves

Yes, thank you. Some very interesting insights there. You've spoken about the rights of retail shareholders and in particular the need to inform them about upcoming votes, which is a particularly hot topic at the moment given the recent action by Saba. Do you think this should be a mandatory requirement therefore for retail platforms?

Baroness Ros Altmann

Absolutely. No debate, absolutely.

Jo Groves

OK. Would you like to expand?

Baroness Ros Altmann

Well, if the platforms are holding. Information that the company doesn't have, and know that their customers are holding shares and also know that actions are happening which could be fundamentally destructive to the interests of those shareholders, they must have an obligation to let them know, because they are the only ones that are in a position to do so.

Jo Groves

Absolutely. Changing tax slightly and moving on to the equally hot topic of pensions, pension fund holdings of UK equities have fallen to an historic low, down from about 30% in the 1990s to less than 2% currently, which is helping to contribute to the underperformance of UK equities, certainly relative to their US peers, would you like to see a tightening of the Mansion House reforms to ensure a minimum level of investment by pension funds into UK equities?

Baroness Ros Altmann

Again, absolutely yes. I was staggered that the Mansion House reforms have no requirement to put a penny of the money pledged to go into small stocks, unquoted, unlisted companies, has to be put into the UK. You know, it just seems to me that taxpayers may be sort of being taken for a ride a little bit here. They are putting over £70 billion a year into people's pensions in tax and National Insurance relief every year, and there is no requirement for a quid pro quo, that a penny of that money has to go into the UK and very little of it has been doing so, which means that all that £70 billion is helping other countries and not us at a time when we desperately need long term investment, the government is desperate to attract overseas investors here. But what message are we sending?

You know, we've got all this massive amount of domestic fund flow looking to invest, and is voting with its feet to say we don't want to put the money here. We underweight our own market. It becomes a self-fulfilling prophecy and it's a kind of vote of no confidence in our own country. And to this extent, we are a global outlier. We're kind of the mugs who, you know, spend taxpayers money for long term investment, living in a country which desperately needs more long term investments, and saying fine go and spend it everywhere else and not here.

Well, where are we going to find the money for our own long term investment from then? You know it just seems a no brainer to me that there has to be a rethinking of the way this is going on and what's happened has been a real doom loop. You know, I understand that there has been a desire to diversify more broadly, and there has also been a desire to lower cost. That has led people to put more and more money into global index tracking funds, especially on the equity side. It's also driven people to have more money overseas than here. But if you look at other countries, their pension schemes - you know Australia, France, Germany, America, Japan, Singapore - you know, all these countries have massive overweights in their own domestic markets, and quite right too! Because if they can't support their own country, it's hard to imagine why they should expect other countries to do that for them and not themselves.

Whether or not you mandate it, I know is a contentious topic. My own solution would be to say, look, you get very generous tax relief for putting your money into pensions and the taxpayers investing alongside you. If you want the tax relief, you have to, as a quid pro quo, put a minimum proportion of new contributions into domestic UK markets. Some can go into the FTSE, some in big companies, some in small companies - you don't need to be quite so directive.

Any change of that nature - the figure I came up with was 25%, but you could easily justify quite a bit more than that, but let's say 25% because at least 25% of every pension fund can be taken out tax free - that 25% of new contributions has to go here. If there was that regular, ongoing flow of domestic money going into our markets, which when I started managing pension funds in the early 1980s was there, I'm convinced was part of the reason, or maybe a significant reason, why we became a leading global financial centre and our equity markets had done so well comparatively, then if we can restore that domestic underpin and fund flow, overseas investors will come too. All our markets will start to be re-rated - we have suffered a tremendous derating, we're very undervalued relative to the rest of the world - and that could start to unwind the doom loop and become a virtuous circle, which is long overdue and desperately needed.

Jo Groves

Yes, as you say, that seems a very pragmatic solution to the issue. There's also been a lot of press speculation about possible changes to ISAs, both in terms of a British ISA, which in fairness, has rather struggled to gain traction, and also exit penalties on lifetime ISAs. What are your thoughts on widening the appeal of stocks and shares ISAs for UK investors?

Baroness Ros Altmann

Again, my strong view is that given where the economy is, given where we are in terms of the fiscal constraints and the need for long term investment, I would like to see a revival of the tax relieved investment vehicles being UK focused. You know, if you want to put £20,000 away for the medium term in a stocks and shares type ISA - although I would personally like to have just one allowance that you could put some in cash and some elsewhere if you wish - it should be focused on the UK. And if you want to put your money in a bank, that's fine too.

The lifetime ISA I have a problem with because I see it as a bit of a no man's land. You know, it's not a pension and it's not an ISA, and it's also got these penalties which make it unsuitable for a lot of the people that it was sold to, especially when you factor in the cost constraint on the property that you have to purchase with it, and the potential losses that people don't know about and don't realise and has not been properly explained to them when it was sold to them.

Jo Groves

Absolutely.

Baroness Ros Altmann

So I'm not sure why we really need a lifetime ISA. If you want to help to buy ISA to help people buy a home, we've got that.

Jo Groves

Absolutely. And one last question for you, if we may. You recently wrote a very interesting article arguing that current monetary policy is undermining both economic growth in the UK and also unsettling financial markets. What steps would you like the Bank of England to take in order to restore confidence for both businesses and investors?

Baroness Ros Altmann

So, there are two main elements here. The first is I would like to see an announcement that the Bank of England has put quantitative tightening on hold - active quantitative tightening - so that it is not, let's say, for the rest of the year going to sell gilts back into the market trying to find buyers at this point in time. The reason I say that is 1) I think it has been a marginal factor in unsettling the gilt market and part of the reason why our yields are so much higher than some other countries - with much worse fiscal positions than we've got, by the way - I don't see the rush to unwind QE. But I do see the urgency to try to restore the fiscal position and stop the government spending more and more and more on interest cost on our debt relative to other countries.

And of course, every time the Bank of England is selling a gilt, it is passing a loss to the Treasury. And again worsening the fiscal position. So, for me, that's an urgency. The second thing is I do believe that short rates have been kept too high for too long and need to come down more quickly and it certainly doesn't make sense, the fact that the Bank of England has already - very, very marginally but anyway -brought down the base rate a bit and is carrying on with QT, So, on the one hand you're easing policy, and on the other hand, you're tightening policy.

You know, that conflict to me doesn't make sense and QE was a massive monetary experiment - we don't quite know what the fallout is for asset pricing generally, and we don't quite know what the long term outlook will be. But what is clear is that unwinding QE, which was a massive monetary easing, is going to be a monetary tightening, and on top of big tax rises coming along and fiscal tightening in an environment where the government agenda is all about growth, something does not stack up.

So, I would hope that given inflation is relatively low, real rates are very high and looking ahead to next year the growth outlook in the face of tight monetary and fiscal policy cannot be said to be strong, there is, in my view, a clear justification to argue I know some people disagree that monetary policy is currently too tight and needs to be urgently eased for a number of reasons that we've just gone through.

Jo Groves

Thank you. Some very interesting thoughts on how to kick start the economy. And on that note, Baroness Altman, many thanks for joining us today.

Baroness Ros Altmann

It's been a pleasure. Can I just put in a plea to anyone who's listening? If you are a shareholder in any of the six remaining trusts with votes coming up, please do get out and vote.

Jo Groves

Thank you very much and we hope you've enjoyed listening to this special edition of Market Matters.