Marketing material

In focus

Causes and consequences of the dramatic changes in ownership of the UK stock market in the past 55 years

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Individuals once dominated ownership of the UK stock market, but they lost their influence to pension funds and insurance companies, who in turn have been overtaken by (largely institutional) international investors. However, rather than a cause for alarm, these changes can be seen to be a force for good – but only if stewardship is not relegated to a box-ticking exercise.

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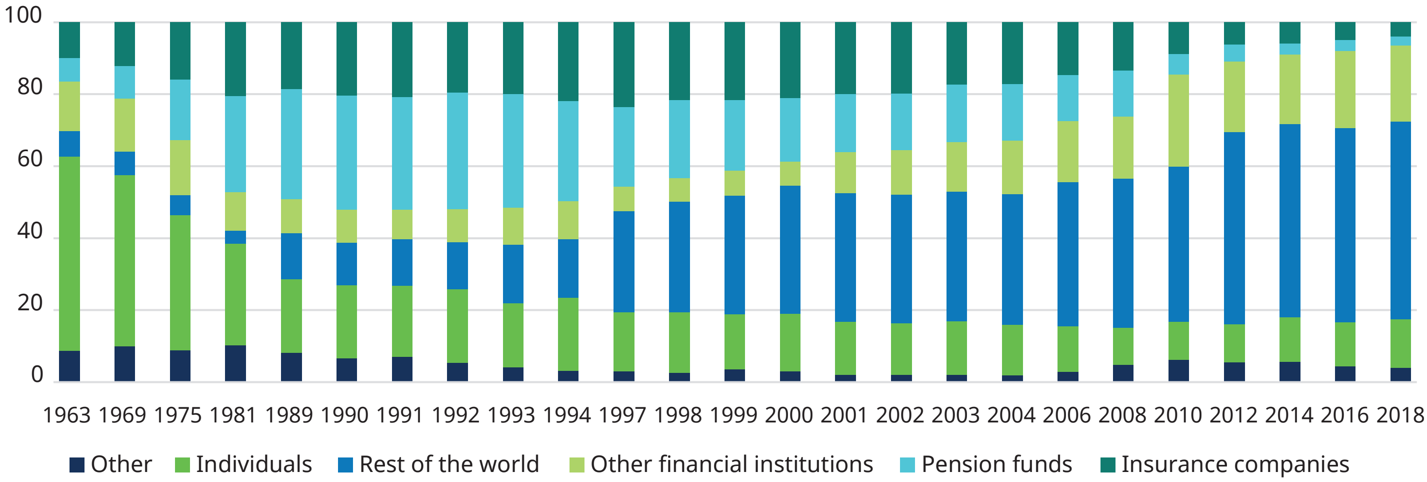
Beauty is in the eye of the beholder, so the saying goes. What then should we make of the dramatic shift in ownership of the UK stock market over the past 55 years (Figure 1)?:

- In 1963, more than half the stock market was held by UK individuals
- In the early 1990s, more than half was held by UK pension funds and insurance companies
- Since at least 2012, more than half has been held by overseas investors

Nowadays, individuals only directly own 13.5% of the UK stock market and the combined holdings of pension funds and insurance companies amount to only 6.5%.

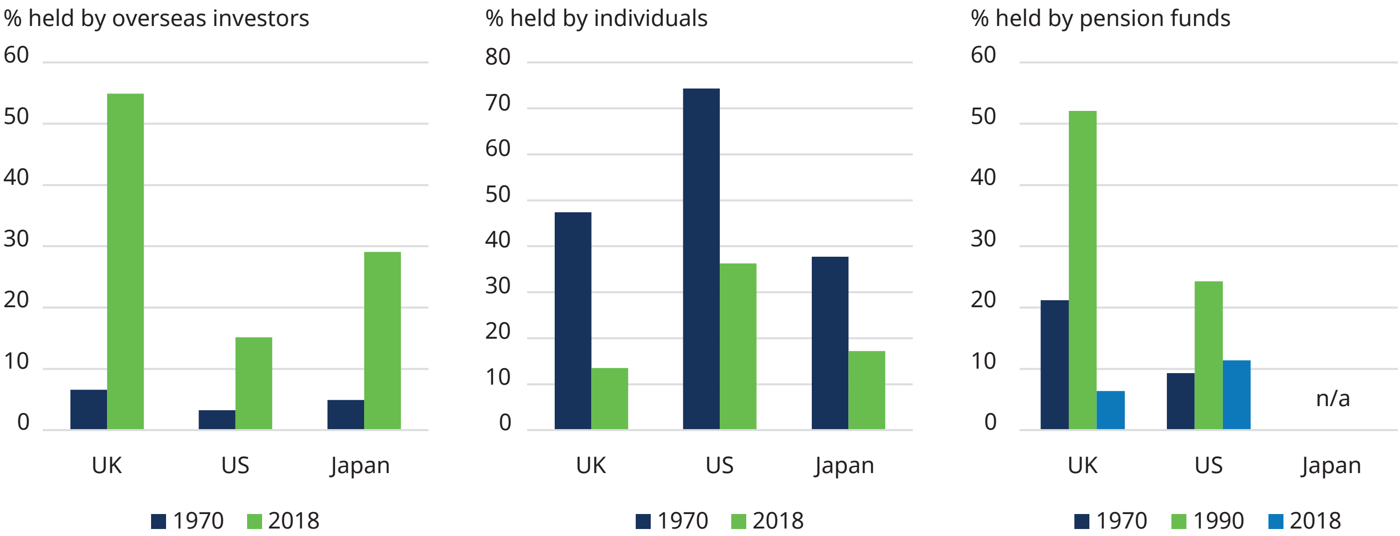
There will be those who decry the dwindling role of the individual shareholder and stoke fear over the influence that overseas investors now exert. But the story is not as bleak or as simple as that.

Figure 1: The changing face of UK stock market ownership



Other financial institutions includes banks, investment trusts, unit trusts, and others. Data to 31 December 2018. Data limitations mean that dates are not evenly spaced. Source: Office for National Statistics (ONS), Schroders. Note: 64% of shares in terms of value are held in multiple ownership pooled accounts. The ONS has allocated these to individual beneficial owners using further analysis of share registers.

Figure 2: Soaring internationalisation | **Marginalisation of the individual** | **Pension funds have been and gone**



UK is for 1969, not 1970. Source: Office for National Statistics , US Federal Reserve, Bank of Japan, Schroders.

These trends are not unique to the UK (Figure 2). Over 90% of the US stock market was held by individuals in the 1950s but, even though stock market investing remains more of a cultural norm there than elsewhere, individual ownership has fallen to 36%[1]. Similarly, individual ownership of the Japanese stock market has fallen from 38% in 1970 to 17% in 2018.

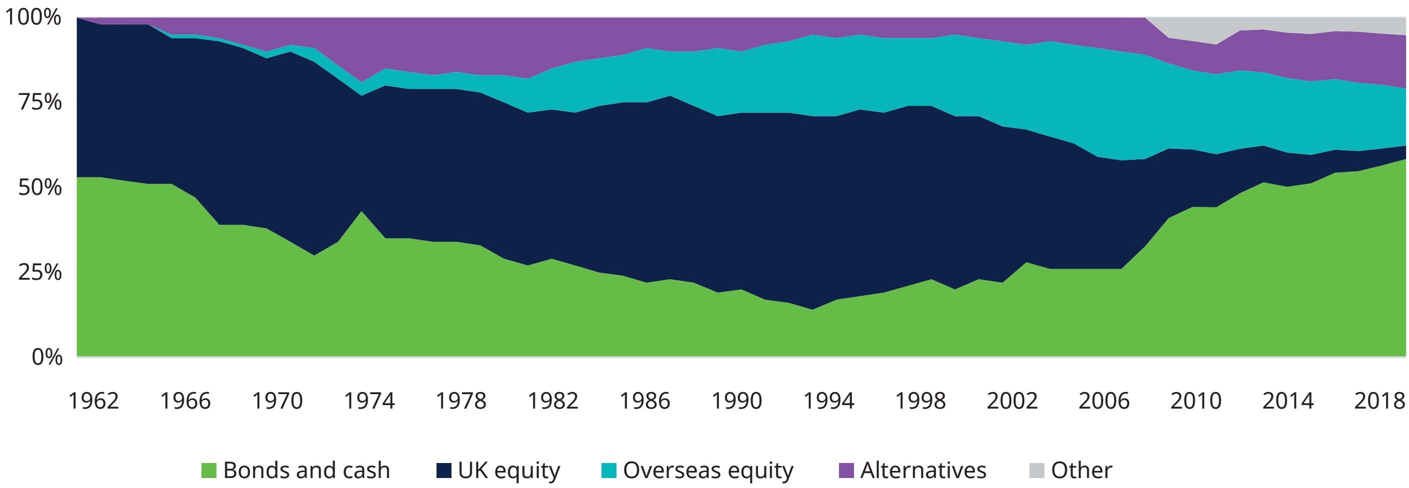
Internationalisation has occurred everywhere, although not normally to the extreme levels experienced in the UK.

Pension funds displaced individuals before being displaced themselves

Employer-sponsored pension funds proliferated in the 20 years after World War II. The proportion of the UK workforce enrolled in one increased from 15% just before the war to about 50% in 1965. US coverage went from 22.5% in 1950 to 48% around 1970. As the second half of the twentieth century progressed and the assets of these pension funds swelled, they became increasingly influential investors. The 1950s also represented the birth of the "cult of equity" – the belief that the stock market was a better place for long term savings than lower risk assets such as government bonds and deposits. In the early 1960s, over 50% of UK pension fund assets were invested in bonds and cash. By the mid-1990s this had fallen to only 14%. The average allocation to equities peaked at 81% in 1993, with 57% in the UK and 24% overseas.

1 Source: US Federal Reserve. Note that for reasons it is not worth going into, hedge funds are covered under households in the US federal Reserve Flow of Funds data. True individual ownership will be lower than the stated figure.

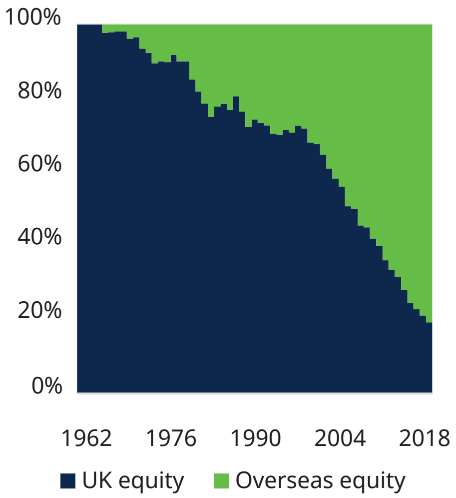
Figure 3: The evolution of UK pension fund asset allocation



Note: Prior to 1995, alternatives is solely comprised of real estate. Data to 2018. Source: 1962–2007: UBS Pension Fund Indicators. 2008–2018: Pension Protection Fund Purple Book 2019. Purple Book data relates to 31 March of each calendar year. This data has been assumed to relate to the preceding calendar year e.g. 31 March 2019 allocation is assumed to relate to 2018.

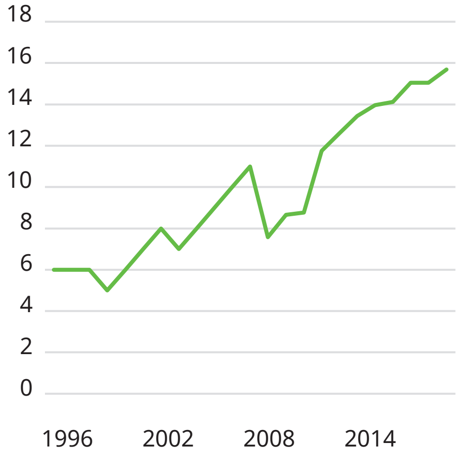
Figure 4: Reduced home basis

UK/overseas stock market split



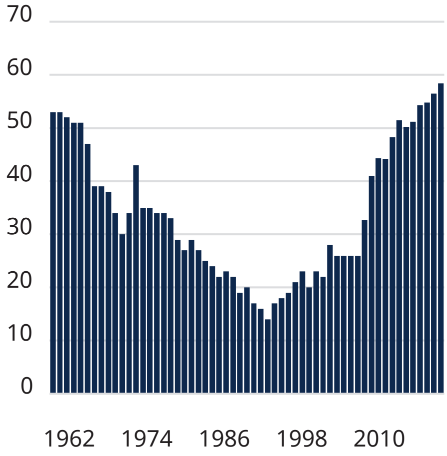
Diversification into alternative asset classes

Average allocation to alternatives



A big move into bonds

Average allocation to bonds and cash



Data to 2018. Source: 1962–2007: UBS Pension Fund Indicators. 2008–2018: Pension Protection Fund Purple Book 2019. Purple Book data relates to 31 March of each calendar year. This data has been assumed to relate to the preceding calendar year e.g. 31 March 2019 allocation is assumed to relate to 2018.

Three forces subsequently saw the waning influence of UK pension funds on the UK stock market (Figure 4):

1 A shift away from domestic stocks in favour of more global portfolios. As recently as 1990, around three quarters of the average UK pension fund's stock market portfolio was invested in the UK, with only a quarter overseas. Today, over 80% is overseas. Home bias has reduced significantly (but not disappeared entirely, given the UK was only 5% of the global stock market at the most recent point in the chart above).

   This internationalisation of UK pension fund portfolios has been mirrored elsewhere. The majority of overseas investment in the UK stock market has come from overseas institutional investors, such as pension funds. The US is the most common source, followed by Europe ex UK.

2 Increased diversification away from the stock market in favour of alternative asset classes, such as real estate, hedge funds and private equity.

3 The biggest of all has been the seismic shift into bonds. Having been only 9% of portfolios in 1993, they are now over 60%.

   The reasons behind this are complex but are influenced by a combination of regulation and more limited tolerance for risk. The lowest risk "match" for a pension liability is a stream of fixed and inflation-linked cash-flows, which has encouraged pension funds to move further into these assets to manage risk. The deep losses in 2001–03 and again in 2008 also left many uncomfortable running a large "bet" that the stock market could reliably meet their liabilities.

Anyone expecting that it would be possible to reinvigorate defined benefit pension (DB) fund investment activity in UK plc by changing regulations or valuation methodologies is sadly misguided. That battle was lost long ago.

In contrast to the drawn out winding down of DB pensions, assets invested in defined contribution (DC) pensions are likely to grow substantially in the coming years. Thanks to auto-enrolment, the number of individuals in such plans has soared from less than one million in 2012 to almost ten million in 2018. However, these funds are likely to invest on a global basis, with a relatively low allocation to the UK stock market. In addition, while a DB fund may have direct holdings in individual company shares, DC holdings are almost universally made via funds. In these situations, individual stock buy and sell decisions and stewardship responsibilities rest with an external investment manager.

Are these shifts a win or a loss for society?

Rather than viewing the shift in ownership from individuals, to pension funds and insurance companies, to overseas investors as multiple changes, it would be better to think of them as only one: a shift from individual ownership to institutional ownership. UK pension funds and insurance companies replaced individuals and have themselves been largely replaced by international institutional investors. This trend towards institutional ownership is a global one that has affected all markets (with the exception of some emerging markets).

However, when you follow the money from these institutional investors to the ultimate beneficiaries of those investments, you are still likely to end up with individuals. For example, a pensioner is the beneficiary of a defined benefit pension plan; a policyholder the beneficiary of a life insurance contract; a saver the beneficiary of an investment fund; and students the beneficiaries of a university endowment.

So the real question is whether the shift away from individuals making direct investments in individual stocks towards institutional investors doing that on their behalf is good or bad. Who is the better steward?

One popular view is that individuals are more likely to be engaged investors, as they form a personal connection with the companies in which they invest. The theory is that they have a sense of ownership rather than of financial investment alone.

This can be contrasted with today's environment, where those doing the investing (such as asset managers) are often several steps removed from the end individual on whose behalf they are managing money. According to Andy Haldane, Chief Economist at the Bank of England, individuals "tend to have little direct communication with, involvement in, or indeed knowledge of, the firms in which they are investing".

However, this image of engaged individual shareholders represents a misunderstanding of how individuals and institutions exercise their rights and responsibilities as shareholders in practice. Although highly engaged individual shareholders do exist, they are in the minority. Studies have shown that individuals cast votes representing less than 30% of the shares they own.

There can be practical reasons for this. For example, individuals normally hold shares via nominee accounts, where the nominee's name (such as their stockbroker or online investment platform) is on the share certificate rather than the individual's. This makes many aspects of share ownership more efficient but it does mean that individuals usually have to make a request if they want to vote, which makes the process much more cumbersome. The UK's Law Commission has recently released a scoping paper looking specifically at the problems with and potential solutions to these challenges.

In contrast, institutional investors vote on over 90% of their shares. As institutional investors typically have much larger stakes than the average individual investor, they also have more clout to effect change at the companies in which they invest.

In this sense, the shift toward a more institutional shareholder base can be seen to be a positive development. When considered alongside the growing number of stewardship codes and frameworks around the world (see here for the UK one or here for the US), standards of stewardship have arguably never been higher.

Of course, this does not mean that individuals are disengaged with how their money is invested. For example, 57% of respondents to Schroders' 2019 Global Investor Survey (a survey of over 25,000 people, from 32 locations around the world) said that they would always consider sustainability factors when selecting an investment product. Investors increasingly care about how their returns are generated as much as the level of those returns. Day-to-day engagement with individual companies, however, is delegated to the investment manager that individuals choose to partner with.

Stewardship should not be a box-ticking exercise

However, that does not mean that everything is perfect. Voting, while better than not voting, is not the only measure of shareholder engagement. Many institutional investors outsource the thinking on how they should vote to external third parties, known as "proxy voting advisers". Some do whatever these advisers recommend without a second thought. There are practical reasons for this. There are roughly 3,000 companies in the MSCI All Country World index, with the smallest company being only 0.00002% of the index. It is simply not possible for anyone but the most well-resourced investors to cover such a large number of companies, each with its own set of shareholder resolutions to be voted on, effectively.

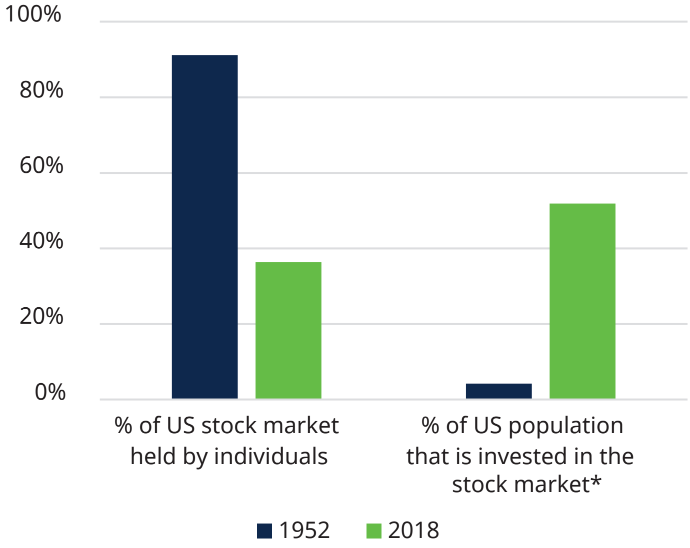
Voting is also only one part of stewardship. Behind the scenes engagement to positively influence corporate behaviour is just as important, if not more so.

It is important that asset managers, while seeking to manage resources, do not relegate stewardship to a box-ticking exercise. It needs to be an integral part of the investment decision-making process. Unchecked, risks could build up, and put money at risk for the individuals on whose behalf they are ultimately managing.

Democratising access to the stock market

In 1952, over 90% of the US stock market was held by individuals. However, those holdings were concentrated in the hands of the wealthiest parts of society. Only 4% of the population were shareholders. In contrast, today even though the share of the stock market directly held by individuals has fallen to only 36%, over half the population has some form of exposure to the stock market, mainly via a retirement account. Ownership is far more dispersed (Figure 5).

Figure 5: The institutionalisation of investing has broadened access to the stock market



* Relates to 1952 and 2016 as more recent data unavailable.
Source: Rutterford, Janette and Sotiropoulos, Dimitris P. (2017). The Rise of the Small Investor in the US and the UK, 1895 to 1970. Enterprise & Society, 18(3) pp. 485–535, and US Federal Reserve Flow of Funds, US federal reserve Survey of Consumer Finances (SCF)

Similarly, despite individual shareholders controlling over 50% of the UK stock market in the mid 1960s, only an estimated 3% of the population – fewer than 2 million individuals – were shareholders around that time. However, similar to US, even though the share of the stock market directly held by individuals has collapsed, a much higher percentage has some form of indirect exposure today. For example, 77% of UK employees are members of a workplace pension scheme, through which they are likely to have some exposure to the stock market.

Arguably, institutional ownership has been the single biggest factor in the democratisation of the stock market.

Should we be worried about increased international ownership?

As described earlier, most of the overseas owners of UK stocks are institutional investors based in the US and Europe. While this institutionalisation can be considered a positive development from a stewardship angle, it is easy to jump to the conclusion that it makes the UK stock market more vulnerable to shifts in international sentiment about the UK. But the reality is more complex. First, the UK stock market is full of international and multinational companies, who sell goods and services around the world. Three quarters of sales of companies in the FTSE 100 index – the part of the market which attracts the lion's share of overseas investment – come from overseas. As a result, an investment in the FTSE 100 is not remotely a bet on the prosperity of the UK economy (in contrast, the FTSE 250 midcap index has more of it domestic flavour to it).

It is true that some of those overseas holdings could be tactical, rather than strategic. This could make the market more vulnerable to outflows. But there has been little sign of this so far, despite the UK having come through a turbulent period following the Brexit referendum. The share of the market held by international ownership has continued to rise during this period. Although sentiment studies have shown the UK stock market has hardly been flavour of the month, fears that overseas owners would rush for the exit have proved unfounded.

Conclusion

Ownership of the UK stock market has changed out of all recognition in the past 55 years. Institutional investors now dominate. The responsibility to be effective stewards of companies listed on the UK stock market lies squarely at their door. Their greater propensity to fulfil their duties and vote on their shares should be reassuring. However, there is a big difference between stewardship as a box-ticking exercise and effective stewardship. Individuals may be several steps removed from the companies in which their money is invested, but that should not prevent them from holding to account those who have been entrusted with that responsibility.