REFORMING UK SHARE OWNERSHIP

Proposals for reforming share ownership

This document provides some options on how the existing system of share ownership in the UK might be reformed to provide full shareholder rights for all investors in public companies.

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SOME PRACTICAL SOLUTIONS

FOREWORD

In October 2014, the UK Individual Shareholders Society (ShareSoc) launched a campaign to tackle the problem of the vast majority of individual investors in UK public companies being disenfranchised. We published a 32 page document at that time called "Guaranteed Votes for All Shareholders" which explained how this situation had arisen, detailed the practical problems that investors face, and set down some principles as to how the problems should be rectified. That document is available from our campaign web page here:

www.sharesoc.org/shareholder-rights.html

The use of nominee accounts, which has become the dominant way via which most investors now invest, is the key problem. Most stockbrokers now only offer those to new investors and all ISA and SIPP accounts must be nominee accounts. Because new stock market investors tend to open ISA accounts because of their tax advantages, it is likely that over time almost all retail investors will be using brokers' nominee accounts unless something is done to change this.

The only investors who are now on the share register of a company, and hence have full rights, are those using Personal Crest accounts (which brokers are now actively discouraging and few offering) or those holding paper share certificates. Such certificates will definitely disappear by the year 2025 due to the EU imposed Central Securities Depositories Regulation (CSDR) which already has legal force. Paper share certificates are already no longer a very practical way for investors to buy and sell shares because of the settlement time requirements and security risks associated with them.

Rights of Nominee Shareholders*

"Why should nominee operators have investor rights?"

It is surely odd that nominee operators (i.e. your stockbroker) have the rights endowed by the Companies Act on shareholders. Investors via nominee accounts have no such rights (voting rights, information rights, rights such as the ability to requisition meetings and other rights) because only the nominee operator has their name on the register as a "Member" of the company.

All these rights are very important to ensure good corporate governance and that the owners of a company have the final say in important matters. The only variation of the position of investors in nominee accounts was introduced by the revised Companies Act in 2006 which gave the Member (i.e. the nominee operator in the case of nominee accounts) the ability to pass on certain rights, if they cared to do so to their clients. Most investors are now reliant on the goodwill, and indeed administrative efficiency, of their stockbroker to obtain even the meager rights available. This seems most peculiar if you think about it.

Many years ago when the Companies Act was first developed there was an alignment between the owners of the shares who had a financial interest in the company and those on the register. In general, everyone who purchased an interest in a public company was issued with a share certificate and was listed on the register. It was obviously sensible that those who had purchased an interest got the rights mentioned above. He who pays the piper should call the tune might be a way of putting it.

But now we have the situation where the nominee operator, who is simply providing an administrative service as an intermediary, gets those rights instead of the beneficial owner. This is surely nonsense. Why should the clerks be getting the rights that an investor is paying for? In the current topsy-turvy world of stock market trading, the rights an investor should obtain have been diverted and subverted by the stockbrokers in their role as intermediaries.

The best solution to this is of course to have all beneficial owners on the share register of a company, as ShareSoc has advocated, with a clear record of any assignment of rights. That way the investors who paid for the rights get them.

The other big problem with the nominee system is that it totally defeats shareholder democracy which is important if the managers of a company are not to abuse their position. Investors have no way of communicating with other investors (which they could easily do when everyone was on the share register), and even a company has difficulty in talking to their own investors.

The Purpose of this Document

This document covers some of the options available that might be considered to rectify the aforementioned problems.

Roger W. Lawson
Deputy Chairman, ShareSoc

* Note that in this document the term "shareholder" is used to describe anyone with a direct or indirect interest in a certain number of shares in a public company, whether they are shareholders on the register of a company (i.e. members) or simply beneficial owners with someone else (typically a nominee operator) holding and recording their interest on their behalf.

1. The Objectives and the Principles

There are two key objectives that need to be covered by any revised stock trading and registration system:

1. It must replace existing paper share certificates issued by public companies and introduce a new low cost electronic system. In other words, such shareholdings must all be "dematerialised". This is not quite such a massive step as one might believe because almost all public company share transactions are recorded in the Crest electronic system, and share registers are also all recorded in electronic form. The only part of the system that remains on paper is the retail transaction handling. But retail investors who still hold paper certificates need to be satisfied that the replacement system is both easy to use and secure.

2. It should also solve the problems associated with the widespread use of nominee accounts. Nominee accounts disenfranchise investors, create legal difficulties and put the investments at risk. Incidentally these are almost all "pooled" accounts where multiple retail clients holdings are intermingled with only one holding in the nominee operators name on the share register. Although Crest supports "designated" nominee accounts where individual client holdings are recorded separately, in reality the only designation within the account is a stockbrokers account number, not the name and address of the beneficial owner.

It was a recommendation in the Kay Review that "*The Government should explore the most cost effective means for individual investors to hold shares directly on an electronic register*" and that recommendation was accepted by the Government. Proposals on how this should be supported therefore also need to be developed.

In the document that was previously published, we spelled out the principles we considered should be followed in developing any alternative to the existing systems.

PRINCIPLE 1. THAT A MODERN LOW COST SYSTEM OF ELECTRONIC SHARE REGISTRATION SUITABLE FOR DIRECT USE BY RETAIL INVESTORS BE ESTABLISHED AS PART OF ANY DEMATERIALISATION INITIATIVE; and

PRINCIPLE 2. THAT THE IMPLEMENTATION OF A COMPREHENSIVE ELECTRONIC SHARE REGISTRATION SYSTEM TO MEET THE CSDR DEMATERIALISATION REQUIREMENTS BE EXPEDITED.

In our suggestions, we assume that there will still be a need to support the use of nominee accounts to cope with the needs of those individuals (or organisations) who require "blind trusts" (e.g. politicians) or who do not wish to be informed about the affairs of the companies in which they are invested.

However the use of nominee accounts has expanded way beyond those purposes in recent years. This should surely be changed. So these are two of our key short term recommendations:

PRINCIPLE 3. THAT RETAIL CLIENTS ARE ALWAYS FULLY INFORMED ABOUT THE LOSS OF THEIR RIGHTS BY THE USE OF NOMINEE ACCOUNTS AND ARE ALWAYS OFFERED AN ALTERNATIVE WITH FULL DIRECT RIGHTS (AN OPT-IN NEEDED FOR NOMINEE USAGE); and

PRINCIPLE 4. THAT ANYONE USING A NOMINEE ACCOUNT IS NOT DEPRIVED OF THEIR RIGHTS AS A SHAREHOLDER IF THEY CHOOSE TO TAKE THEM UP AND THAT ALL NOMINEE OPERATORS MUST PROVIDE WAYS FOR THEM TO DO SO AT NO CHARGE.

The mandating of the use of nominee accounts by ISA and SIPP providers has encouraged the growth of the use of such accounts, so our next principle is:

PRINCIPLE 5. THAT THE GOVERNMENT SHOULD ENSURE THAT ANY TAX BENEFICIAL ACCOUNTS ARE CAPABLE OF CONTAINING DIRECT HOLDINGS AND SHOULD NOT REQUIRE THE USE OF NOMINEE ACCOUNTS.

The inability of other shareholders to communicate with beneficial holders who hold shares via nominee accounts has made it exceedingly difficult to communicate concerns about the management or operations of a company to all shareholders or obtain proxy votes in support, so this is another principle that is important to restore shareholder democracy:

PRINCIPLE 6. THAT IT SHOULD BE POSSIBLE TO COMMUNICATE WITH ALL BENEFICIAL HOLDERS OF SHARES IN A COMPANY AT LOW COST IN A SIMILAR WAY TO THE CURRENT PROVISIONS ON PUBLIC ACCESS TO SHARE REGISTERS.

To support the above might require significant changes to both Company Law the Regulations (for example in the ISA and SIPP Regulations), so our last principle is:

PRINCIPLE 7. THAT THE COMPANIES ACT AND ASSOCIATED REGULATIONS BE REVIEWED WITH VIEW TO UPDATING THEM TO BE MORE APPROPRIATE TO THE WAY THAT PUBLIC COMPANIES OPERATE AND THEIR SHARES ARE NOW TRADED.

The possible approaches to implementing the above principles are covered in the following chapters.

2. Meeting the Dematerialisation Requirement

As stated in the previous Chapter, there is a legal requirement to meet the CSDR requirements to remove paper share certificates in the next few years. To do so can be achieved in more than one way. Three options are:

a - Personal Crest Accounts. One solution is to encourage the use of Personal Crest Membership and ensure it is low cost and widely available, so that certificated holders could move their shares into that form - possibly providing one default broker to provide such a service if a client does not choose another. Cost is not necessarily an issue as those brokers who do offer Personal Crest accounts frequently charge no more than for the use of a nominee account and the processes used are not enormously different. But there seem to be several reasons why stockbrokers do not offer or promote it. These include:

(i) The time it takes to open a Crest account, which is not solely under the control of the stockbroker.

(ii) The fact that dividends are paid out directly to the investor (typically via cheque) rather than being paid to an account held by the stockbroker as with nominee accounts - because stockbrokers make substantial profits on the cash floats held in client accounts. However, Personal Crest members do have linked cash accounts used for dealing purposes, so there is no great reason why this could not be linked into the registrars systems for dividend distribution. This would have advantages in terms of payment security also for Personal Crest members.

(iii) The fact that brokers, and some of their clients, object to personal contact information being present on the registers of companies. This was a possible risk before the "proper purpose" limit on share register access was introduced in 2006, and could be tightened up further by providing an opt-out (not opt-in) to clients upon request. That would satisfy the client's needs and there is no good reason otherwise why brokers should object.

b - Corporate Nominee Accounts. Move shareholders into corporate nominee accounts. These are like broker nominee accounts but are created and managed by the share issuers (i.e. companies). In practice they are usually managed by a third party such as a registrar. They have been used to simplify some large public offerings of shares in the past. But their disadvantages are the same as for all nominee accounts and hence are disliked by investors. For example they do not protect shareholder rights adequately. They certainly do not enable investors who hold share certificates to remain on the share registers of companies, and would require investors who hold shares in a multitude of different companies potentially to have to deal with multiple registrars. ShareSoc would oppose the adoption of this approach.

c - Name on Register. A Working Group comprised of a number of securities market stakeholders have recently published a paper entitled "An Industry Proposed Model for Dematerialisation" (See Appendix B). They do not appear to have assigned a name as yet to this model so we have called it "Name on Register" in the following discussion.

This model provides an electronic registration system to replace paper share certificates and assumes that all holders of the latter would be transferred into the new system in due course (probably all on a defined date).

Investors would be able to continue to trade as at present (i.e. by phone, on the internet, etc) and their holdings would be recorded on the share registers of companies so their rights as shareholders would be protected.

It should be low cost for brokers and other parties to undertake transactions, certainly lower than the use of paper share certificates, and comparable to the use of nominee accounts. The last time such a system was looked at in detail, substantial cost savings were forecast across the industry.

The system would have advantages for retail investors in terms of improved security, ease of trading (no need to post certificates back and forth for example), lower cost and quicker settlement on sales. It would also support "Off-market transfers" which are still important in some circumstances.

"advantages for retail investors - improved security, ease of trading, lower cost and quicker settlement"

ShareSoc is supportive of this approach (subject to consideration of the details) as one solution to meeting the CSDR requirements for dematerialisation (but see below for reservations).

However it does not tackle the problem of nominee accounts. Without some legal requirement to offer investment via "Name on Register" to all their clients, stockbrokers would not do so. Or they would discourage take-up by discriminatory pricing or other tactics. The number of investors on the registers of companies would continue to decline and the number in nominee accounts would continue to increase.

Therefore ShareSoc would not be supportive of this approach unless there are complementary measures to ensure widespread take up of these accounts in future, deter the use of nominee accounts and ensure those in nominee accounts are fully enfranchised.

For example, it could be made compulsory for stockbrokers to offer a "Name on Register" account at pricing no higher than nominee accounts, without other discriminatory terms attached, and with the disadvantages (legal and otherwise) of nominee accounts being clearly spelled out to prospective new clients. A "code of practice" for stockbrokers would be one way of establishing this. That would meet the requirements of Principle 3 in our first Chapter:

3. Other Possible Approaches

The "Name on Register" system described in the previous chapter is only one approach to tackling dematerialisation and how to provide a modern, electronic share trading and registration system. It primarily provides an easy solution for those holding paper share certificates with minimal changes otherwise required (for example to legislation and clearing systems).

But there are other possibilities. For example the Australian CHESS system has been in use for some years . CHESS stands for Clearing House Electronic Sub-Register System and is outlined in Appendix A to this document. It's a hybrid system which enables most shareholders in Australian companies to be on the register. It has helped to support a vibrant private investor base in Australia who have been prompt in tackling corporate governance issues in companies registered in that country.

But the system is not perfect. It is worth reading this document from Computershare/Georgeson which describes and contrasts the different share registration systems around the world: http://tinyurl.com/p42jdrc

The Swedish system has a high degree of transparency and the US system does ensure that all investors receive information and can vote, but again is not without problems (for example "over-voting" in this case).

All of these system tend to have been developed piecemeal from pre-existing manual systems and archaic company law. The introduction of nominee accounts by brokers keen to hide their clients and provide other benefits in financial terms has also created difficulties in transparency. Nobody seems to have gone back to first principles and devised a simple computer system that will support:

- Trade recording, clearance and settlement, with a proper audit trail.

- The handling of "corporate actions".

- Information distribution to all investors.

- Electronic distribution of dividends.

- Shareholder rights to all investors including voting, meeting attendance, information and other rights

- Shareholder democracy by providing contact information for all investors.

In regard to the last function, even when such information is available, it is only in the form of a postal address (often provided in printed form) - an anachronism in the modern world of digital communication. That can practically obstruct communication by a company to its investors, or by other investors, simply on the grounds of cost.

4. Dealing with Existing Nominee Accounts

The big problem with Nominee accounts is their lack of transparency. Nobody knows who the beneficial owner is other than the nominee operator who has no obligation to pass on rights or even information.

Clearly it is the issuers who should have responsibility for (and the associated cost) of providing information to their investors. Likewise when it comes to General Meetings they need to know who has the right to attend and to vote. The simplest way to achieve this is to simply to add those in nominee accounts to the share registers of companies.

For example in Sweden there is a monthly electronic "upload" of all beneficial holders to a central share register (and it can be more frequent if demanded). This ensures that companies can communicate with all their investors, and that others can do so also with some limitations. But in Sweden voting cannot be done via intermediaries so shareholders must be on the register directly to be able to vote in Sweden, which is far from ideal.

One potential difficulty with nominee accounts is that there can be multiple layers of beneficial owners. For example a holding present within a pooled nominee account at a UK broker, may represent an investment via a trust company in another country, which represents in turn multiple persons or organisations. This is of course one reason why nominee accounts are legally questionable because they can disguise and confuse who is the real owner of the shares.

Careful consideration has to be given as to how to support this and avoid problems of over-voting if done via the nominee operator. It is probably another good reason for deterring the use of nominees or restricting their use. For example by requiring all nominee operators to disclose the ultimate beneficial owners to the issuer (because of the KYC checks now undertaken to guard against money laundering and fraud in the UK, this information should be generally known).

If an upload of a nominee list is used purely for information distribution purposes, with voting remaining via the intermediary (i.e. the nominee operator), then that might prove a practical if less than ideal solution. All that would be required to ensure good governance would be a requirement for all brokers to provide easy to use electronic voting systems to their nominee clients.

If the "upload" system was adopted a nominee client's presence on the share register would enable them to attend all General Meetings (possibly as a "guest" although that would at present prevent them from speaking so a change to the Companies Act would be needed to cover that).

The option for clients to opt out of the upload of their personal information could be provided if necessary.

Voting via the Nominee Operator - Some Practical Difficulties

One might assume that voting via a nominee operator can work well in practice but this is rarely the case. Here are a few examples reported by ShareSoc members: 1) A shareholder did not vote his shares in Prezzo when a takeover occurred in December 2014 because he simply did not know about the event. His nominee operator (Barclayshare, one of the largest retail brokers) did not inform him about the bid and his right to vote. Brokers have no legal obligation to inform their clients of such votes and most do not; 2) Cas Sydorowitz, who is often involved in proxy battles, comments that some brokers are completely obstructionist and their underlying clients often comment that they cannot vote or that they lodged their votes but they were not recorded (he sees from the voted file that the broker has not lodged anything despite the investor submitting it to the nominee operator); 3) one author of this document is not always able to vote his shares with a nominee operator who otherwise provides an easy to use service to do so - this seems to be problems with timely availability of information to the broker about votes, and the short and critical time window in which they can submit votes to the registrar.

These problems are even more acute when the broker does not provide an automated system of voting to their clients - in this case the client has to manually instruct the broker how he wishes to vote on each resolution, via email or post - an exceedingly tedious process which means the client is rarely going to bother. It should be mandatory that brokers offer an easy to use, automated voting process to their clients and that they submit votes received in time (with penalties if they do not), if this system is to be retained.

"It should be mandatory that brokers offer an easy to use, automated voting process for their clients..."

Lack of Audit Trail

One particular problem with voting via nominee operators is the lack of a clear audit trail. At present, there is no certainty that when a client instructs a nominee operator to vote their shares, that the operator actually follows through on this and does so within the required timescales imposed by the issuer. It should be a legal requirement to provide such an audit trail and there should be a means for a client to check that their votes have been correctly and promptly recorded.

All nominee operators should pass on rights

It should of course be a legal requirement for all nominee operators to pass on the rights they have obtained, e.g. voting and other rights such as the ability to requisition a General Meeting, unless a more direct system can be devised. At present there is no legal obligation to do so and only certain rights are capable of being passed on. The ability to attend a General Meeting of a company is also a problem at present where a "letter of representation" is required by investors in nominee accounts whereas those on the register can simply turn-up and be recognised as a member with voting rights.

Providing Information

A system that provided for the upload of the "beneficial owners" to the register would enable the provision of information rights in a comprehensive way, which is patchy at present. This is a key requirement if investors are going to be aware of when a vote is due, know about the issues they are voting upon, and know the date and other details of a General Meeting if they wish to attend it.

AIM Shares need to covered

AIM shares (and other similar markets) also need to be covered by these systems, which they are not at present. This is a major gap that needs plugging. Putting shareholders in AIM companies on the register, including those in nominees, and giving the associated rights directly would be one solution.

Voting and other rights provided via a Nominee - Summary

You can see that there are numerous problems with voting and information rights being passed on via nominee operators. Even with improvements to existing systems, it is never going to be a perfectly reliable system which is why ShareSoc suggests that nominee accounts be actively discouraged.

Other options to deal with the nominee problem would be to require all nominee operators to give their clients the option of moving their accounts into a Personal Crest or Name on Register account when that is available.

The encouragement of direct holdings rather than indirect ones could be done in other ways - for example by levying additional charges or taxes on such accounts and requirements for more informed consent by their users. Another alternative would be mandate the use of designated nominee accounts - see later in this document.

Other rights

One issue that is not covered by the current Companies Act is that shareholders on the register have some rights that are not capable of being passed on by the broker under Section 9. For example, the right to requisition a General Meeting, or the right to object to a Plc becoming a Ltd company. All rights need to be passed on or provided by the name of the client being on the register of the company.

Another problem is that a shareholder holding shares via a nominee account cannot appoint a proxy to attend and vote at General Meetings (because they are not on the register as direct shareholders). This defeats any collective organising of votes and attendance at AGMs (a beneficial owner cannot appoint someone else to attend a meeting in their place - only the nominee operator can do that).

An alternative to supporting voting via nominee operators

Because of the practical difficulties experienced in providing voting via nominee operators it might be better to consider using an upload of the client details to the register as an alternative way of supporting voting of their shares. This would also enable an easier solution to the problems of "Other Rights" mentioned above. The difficulty here would be timing in that the information upload held by the registrar might be out of date, i.e. holdings would not be those on the "record date" for the meeting. This problem would be overcome if there was an upload from all brokers on the record date itself and the record date moved. This may not be difficult to achieve if an automated process of uploading was put in place which would be sensible anyway.

Alternatively instead of an old-fashioned and infrequent "upload" system there is no reason why nominee operators clients details could not be updated in real time on the register of beneficial owners by the nominee operator (i.e. purchases and sales were transferred as they occurred to the registrar with an occasional "synchronisation" check to ensure integrity - this might be wise for other reasons also). This already happens with "Designated Nominee" accounts - see below.

The brokers are of course already interacting with other systems electronically such as Crest to record transactions (i.e. to clear and settle trades), so it may not even be necessary to invent major new systems, just connect into existing ones.

It cannot be emphasised enough that this is an IT problem in essence which should be solvable by IT methods. Everyone needs to get away from thinking in terms of passing bits of paper around. All votes should be submitted and recorded electronically and information should pass backwards and forwards electronically between clients, brokers and registrars. Those few retail clients who are still not internet enabled should be supported in ways such their requirements are converted to electronic form (backwards/forwards) at the earliest opportunity. It would be best to design an IT system that meets the principles and transaction processing requirements and then look at embodying that design in laws and regulations. At present we seem to have a system that was developed the other way around.

Note that there are some cases where beneficial owners may want to assign voting and other rights to their stockbroker or to a third party (for example a client might not wish to receive information on his investments at all for a variety of specific reasons). This should also be supported by entries on the register.

Designated Nominees

The Crest system and share registers already support the use of Designated Nominees where individual client holdings and transactions are recorded - such clients are present on the register but only under an account number with the contact information present being that of the nominee operator.

It would surely be a simple matter to extend this system to record the client contact details (postal name/address and email address). This would enable issuers to enfranchise the client directly both in information, voting and other rights. The client could have an opt out from receiving information or having their contact details disclosed to anyone, with suitable warnings about that.

Where a designated nominee is present on the share register, the designated person should have the rights as a "member" in terms of information, voting and other rights. Only the payment of dividends would need to be to the nominee operator to simplify administration.

"Pooled nominees should be banned"

The big danger with nominee accounts is the use of "pooled" nominees which create legal uncertainties, problems when a stockbroker goes out of business and creates difficulties in providing enfranchisement. ShareSoc suggests they should be banned and only designated nominees (with suitable improvements) permitted.

Note that the use of designated nominees does not necessarily increase trade processing costs because individual clients trades are recorded in Crest irrespective of whether they are designated or pooled nominee accounts.

The EU Shareholder Rights Directive

Note that the revised EU Shareholder Rights Directive may have an impact on the possible solutions to the nominee problem. The draft Directive includes provisions that enable listed companies to identify their shareholders and to facilitate the exercise of shareholder rights and engagement (there are of course already provisions in UK Company Law that enable companies to request the details of beneficial owners but it tends to be used only in certain circumstances and is often obstructed by nominee operators). In addition it includes the right of shareholders to be able to verify their votes at a General Meeting have been taken into account.

At this point it is unclear what the final version of this Directive will contain and how it will impact UK Company Law or the proposals contained herein, but it is mentioned here for completeness.

5. ISA and SIPP Accounts

ISA and SIPP accounts are particular problems because the regulations associated with such accounts presume they are held in nominee accounts.

At present most retail clients using ISA accounts are not even aware that they have rights to vote under the ISA regulations. Most brokers do not tell their clients about this, nor provide easy to use voting systems. Neither do they provide information such as Annual Reports and when General Meetings are taking place.

One of the reasons why ISA and SIPP accounts require the use of nominees is no doubt because of the need to track cash movements associated with the ISA or SIPP account, e.g. dividends paid into the account. As pointed out previously, even with Personal Crest accounts where brokers already provide a linked cash account, dividends are not paid directly into it. If they were, then there is no reason why ISAs could not be Personal Crest accounts and likewise "Name on Register" accounts.

Alternatively if dividends are continued to be paid directly (for example by allowing ISA and SIPPs to be "Name on Register" Accounts), it may simply be a case of the ISA tax allowance being allowed to increase by the amount of dividends received by the client. Clients could keep track of this, or brokers could provide such information as dividend entitlements are readily available.

The extended use of designated nominee accounts as we have proposed in the previous chapter would solve the problem of course, and that might be the simplest solution to these problems.

6.Reforming Share Registers

Share registers are held in electronic form (typically by one of few company registrar companies, but occasionally by the company itself). There is an obligation under the Companies Act 2009 to provide a copy to any person subject to minimal rules except that the requestor has to have a "Proper Purpose". Unless shareholders can communicate with one another, unreasonable power is put into hands of the company's directors and shareholder democracy can easily be defeated. As to what is a "Proper Purpose" is not defined in the Act and has yet to be established by case law, although ICSA publish some recommendations on what they consider might be reasonable purposes. This rule was introduced to thwart people from obtaining the register so as to harass investors (e.g. in pharmaceutical companies from animal rights activists), or to obtain it simply to provide commercial mailing opportunities (i.e. the junk mail or boiler room problems). This addition has not proved a practical hindrance to shareholders wishing to communicate with other shareholders on the register. But there are numerous other problems that defeat shareholder democracy:

1. Most shareholders are no longer on the register but are in nominee accounts. Only the name of the nominee operator appears and they will not pass on communications sent to them. The solution to this would be to have the contact details of the beneficial owners on the register as suggested above. An alternative, but less than ideal solution, would be to impose on the nominee operator the requirement to forward all communications from the company, or any other person, to their beneficial owners upon request and at the expense of the nominee operator.

2. Although there is a clear presumption in the Companies Act that electronic communication should be used, when a share register is provided there is no clear definition of what format it will be provided in. For example, most registrars will not provide it as a simple spreadsheet that could be easily used for mailing, put as a "print image" in pdf format. In some cases it becomes almost impossible to process that digitally, and it has to be retyped. In others it just adds enormously to the time and cost of getting it into a useable format. By such means, and employing other tactics, companies can delay and frustrate shareholder activism. Rules need to be introduced to standardise the format in which share registers are provided.

3. Share registers, as provided upon request, only contain postal addresses and not email addresses. This thwarts shareholder democracy also because it means the cost of printing/posting communications to shareholders is enormous due to the rise in such costs in recent years. Typically it might cost £1 per item so you can see that even for mid-sized companies it becomes prohibitive to use this approach. Share registers should surely now contain email addresses for investors as well as postal addresses now that email communication is becoming the default mode that most people use (and probably well over 90% of investors).

An investor opt-out from email communications should however be provided of course. If beneficial owners were added to the register, they should also have email addresses added.

Incidentally adding email addresses might also help with the problem that many people on share registers are untraceable, or have "gone away". They move house, or even country, without telling the registrar but there is some chance they won't have changed email address or there is some forwarding address.

Note that registrars sometimes have email addresses already for those investors on the register, but they don't legally consider those to be included in the share register, which is questionable anyway. Registrars are keen to collect email addresses so they can deliver Annual Reports and Meeting Notices electronically so they already actively do this for many companies as this saves their clients (the issuers) money. But the number of those on the register who have provided email addresses is still low.

The above reformation of share register usage would restore shareholder democracy and move them more into the modern electronic age.

7.Conclusion

In conclusion, there are a number of ways to solve the problems associated with nominee accounts, the requirement for dematerialisation, and the need to improve shareholder democracy:

1. An electronic system to replace paper share certificates where retail clients remain on the share register is clearly a prerequisite.

2. Nominee accounts should be discouraged by ensuring a low cost electronic alternative is always available (either by improving the take-up of Personal Crest accounts and/or providing systems such as the proposed "Name on Register" account), and that clients are provided with information on the disadvantages of nominee accounts.

3. Those who prefer to remain in nominee accounts should be placed on the share register of companies as a matter of course and as soon as possible. That should be used to support information and other rights. The easiest and best way to do this would be by extending and improving the use of designated nominee accounts and banning the use of pooled nominees.

4. Ideally the support of voting and other rights by beneficial owners should also be done via the share register, and taken out of the hands of nominee operators who have little interest in providing it and do not do it reliably. Stockbrokers should stick to what they do best - namely providing client facing trading and advisory services, and not be involved otherwise in the relationship between investors and issuers.

5. If voting and other rights remain with nominee operators then the regulations and laws applying to this must be tightened up very considerably, but it is difficult to see how such an arrangement can be made to function reliably.

6. The issue of how ISA and SIPP accounts can be supported by register based accounts needs to be examined, and how dividends can be paid directly into linked accounts held by the broker. But a solution based around the use of designated nominee accounts might be an alternative.

7. The regulations and relevant part of the Companies Act in respect of share registers need to be reformed to support shareholder democracy.

Summary

In this document we have shown that there are various things that need to be done to reform share registration and nominee systems so as to improve retail shareholder engagement with companies in which they have invested. Improving shareholder democracy will have major benefits in improved corporate governance and stopping the common abuses that take place at present. We hope retail investors and other stakeholders will support the proposed changes. Please give ShareSoc your comments on this document. Contact information is on the back page.

Appendix A - The Australian CHESS System

The basic principle behind the Australian settlement system (CHESS) is that trades are settled electronically with no share certificates or signed transfer forms having to change hands. This dramatically reduces the chance of trades failing due to lost certificates or ignored transfer forms, and also materially speeds up the process of transferring shares. What makes the system attractive, apart from the fact that it has been in place in Australia since 1994 and is fully tested, is that it maintains the basic principle for shareholders of own name registration which allows for direct communication between companies and their shareholders, particularly private shareholders.

Below we quote directly from the ASX's manual on the CHESS system, underlining the system's key concept of 'name on register'.

"*The CHESS sub-register is recognized as forming part of the legal register of holders for a financial product, upon which each individual holder's holding and registration details are maintained. This is in contrast to the depository nominee approach to electronic transfer, common in foreign settlement systems, in which holding records are maintained as sub-accounts within the registered holding of a 'super' nominee*." (For 'super' read broker).

Whilst some shares are held in nominee names in Australia, and indeed there are some limited legacy holdings still in certificated form, the new system is primarily aimed at sustaining the own name concept of share ownership in a dematerialised structure. This reinforces the fact that it would be simple for the UK to similarly embrace the concept.

The basic structure is that securities are registered in two ways, both of which ideally entail the registration of the underlying shareholder as the direct owner of the shares. The first registration type is that of a CHESS sponsored shareholder where the involved broker, who has to be a CHESS member in its own right, sponsors a client who then appears directly on the register of the company in which they have bought shares. The second registration type is where a new buyer requests that the broker registers them directly on the company register as the legal owner in a process known as issuer sponsorship, i.e. where the company itself sponsors the new shareholder. CHESS effectively operates a sub-register from which details input when a trade has been carried out - details of the shareholder etc. - are uploaded to the company's register. If you are a broker or an issuer sponsored holder you are given a unique reference number which identifies you on the company register. However, as a CHESS/broker sponsored shareholder you will have just one reference number to cover all your holdings, if you are an issuer sponsored shareholder you will have a reference number for each of your holdings provided by the relevant registrar.

The difference between the two is that if your shares are CHESS/broker sponsored you have to deal in the particular share through the original broker, with an issuer sponsored holding you can trade with any broker you choose.

However when an issuer sponsored holder sells, their shares have to be converted into CHESS registration form before the transfer of ownership can take place, a straightforward and swift process. Settlement is T+3. In terms of the present UK system the two types of Australian registration are not dissimilar conceptually from CREST personal membership and certificated holding.

Once registered under the CHESS system the issuer sponsored shareholder is sent an account statement from the relevant registrar which shows their holding in the company. That is updated after any trade in the particular share by that client. The broker sponsored investor will receive one account from the broker which will show all registered holdings. The purpose of this short explanation of the CHESS system is to show how it operates at the investor registration level not at the exchange operating level. Suffice it to say that operationally the system has a number of linked stages from when the investor places their order to where funds are transferred from the buyer to the seller's account through the client brokers and the new holder is placed on the particular company register.

More information on the CHESS system is present here:

http://www.asx.com.au/documents/research/chess_brochure.pdf

or here:

http://sraa.asn.au/introduction-to-chess.html

Appendix B - An Industry Proposed Model for Dematerialisation

A Working Group comprised of a number of securities market stakeholders have recently published a paper entitled "An Industry Proposed Model for Dematerialisation". This is primarily aimed at replacing the existing usage of paper share certificates by a new electronic system while maintaining the presence of existing certificate holders on the share registers of companies, and hence retaining all the rights they currently enjoy as members of the companies in which they have invested. This note gives some brief extracts from the paper.

The development of the paper has been in large part driven by the requirement under the EU Central Securities Depository Regulation ('CSDR') which mandates that all transferable securities be held in book entry form by no later than 2023 for new securities and 2025 for existing securities. The legislation is therefore relevant to equity and debt securities, including UK government securities ('gilts').

UK and Irish Markets have substantial numbers of shareholders holding their shares directly on the issuer's register rather than through an intermediary (not common elsewhere in the EU and a valued right in the UK and Ireland), and the Working Group believes that the approach to implementing full market dematerialisation needs to reflect this and preserve many of the consequential benefits for issuers and investors.

In the view of the Working Group, the design of the system of dematerialisation should minimise change for all market participants, most notably for currently-certificated investors. Full dematerialisation means that, in the future, certificates will not be issued for listed securities and any existing certificates will become redundant. Although this change is significant, it is important to remember that current registration for listed companies is based on electronic book entry processes and certificates are prima facie evidence, not bearer documents. Consequently, whilst transactions currently supported by share certificates will be impacted, dematerialisation does not necessitate a change in how ownership is recorded.

Under this proposal shares would continue to be recorded in the same manner as today, but without the issuance of a share certificate, and there will be no change to the rights and benefits of share ownership. The proposal retains the key principles of investor choice provided under the current UK and Irish shareholding model, including whether to hold shares directly on the issuer's register (with direct legal title, direct receipt of shareholder communications and direct exercise of shareholder rights) or to use the services of a broker or other intermediary to administer their shareholdings; and the freedom to use a broker of choice when trading. At the same time it is critical to preserve a transparent ownership structure, viewed as positive for engagement and corporate governance.

There is wide ranging support for this approach across all market participants engaged in the debate including shareholder representative bodies, brokers, custodians and issuers.

While the CSDR has been the immediate driver for preparation of this paper, it is also considered timely for the UK and Irish markets to renew their previous efforts to introduce dematerialisation in the light of the recent reduction in the settlement period to trade date plus 2 days ('T+2'), which cannot be met for the majority of certificated shareholders and thus puts them at a potential disadvantage when selling their shares. To benefit from the increased efficiency of full dematerialisation and retain and enhance the competitiveness of our markets, the Working Group urges the UK and Irish authorities to progress this initiative in the near term rather than deferring action until the mandated timeframes presented by the CSDR.

The paper does provide a technical outline how such a dematerialised system would operate, the cost/benefit position, security arrangements and possible transition arrangements.

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