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Dematerialisation – why you should be concerned as it's back on the agenda

The following note was issued by ShareSoc in March 2013 when the issue of dematerialisation being forced by the CSDR regulations came to the fore:

What is dematerialisation? It's the replacement of paper share certificates by an electronic system of registering share ownership. In reality such systems don't actually necessarily get rid of paper for those who are not computer literate but simply change the legal basis of holdings and the underlying systems (and of course, as almost all shares are now traded in the Crest computer system, even if you have a paper share certificate this is more a change of form than substance). Investors would still be able to get a paper "Statement of holding" and "Contract Note" if they wish, although these might more likely be sent via secure email systems in future.

Many other countries have enacted dematerialisation and have no paper share certificates for publicly traded company shares. But in the UK there are still estimated to be about 7 million holders of share certificates. Even sophisticated investors often have some – for example VCT shares are issued in paper form and as there is usually no reason to trade those actively, they tend to remain in paper form. Likewise many people have share certificates from past demutualisations and privatisations.

There is one advantage of a paper share certificate in that your name is on the register of the company, and hence you receive all communications directly from the company and can vote directly (i.e. you have "information rights" and "voting rights"). In addition you can turn up at any AGM and ask questions, speak and vote because you are recognised as a shareholder by the company. Those rights do not apply to those holdings shares in a nominee account where you are effectively disenfranchised and have to rely on your stockbroker if you want to have a say in the running of the company you own. Some stockbrokers are a lot better than others in extending those rights to you but in essence their systems are often complex, difficult to use, unreliable and ultimately a mess. See www.sharesoc.org/nominee_accounts.html for more background information.

However there are a lot of disadvantages with paper share certificates. They are in reality very insecure, create problems with clearing quickly, are expensive for brokers to process and often get lost (when it is expensive for the holder). So a few years ago there was an initiative to create a new electronic share registration system that would replace paper share certificates and enable dematerialisation. After some years of work by a working party representing all affected bodies, this was ultimately not proceeded with. The Government decided it was not a priority and there was lobbying against the proposals by some stockbrokers who apparently would prefer to see everyone stuffed into nominee accounts.

But now the phoenix will arise from the ashes of that debacle because the EU is mandating dematerialisation and probably from the 1st January 2015. This is part of the Central Securities Depository Regulations (CSDR). So the UK Government will now have to tackle this issue afresh.

ShareSoc has a very clear policy on this matter which can be summarised as follows:

1. We support the principle of dematerialisation because of the advantages it provides to shareholders.

2. It is essential that UK legislation enacting the CSDR guarantees dematerialised holders identical rights to those of current certificated holders. Without such guarantees, current certificated holders would have cause for concern and we could not support the proposal. Those rights (which must be granted without charge by the issuer or depository) include:

- The right to receive all shareholder communications directly from the issuer, either postally or electronically, according to the shareholders' selection.
- The right to attend, speak and vote at all general meetings of the issuer.
- The right to be recognised as a full member of the issuer under its Articles, and the ability for the issuer and others to communicate directly with such members which is what their presence on the register of the company currently guarantees.

3. That shareholders have the choice as to how to hold their shares and are not forced into nominee accounts.

Before anyone points out that there is already an electronic share dealing system called Personal Crest Membership which is certainly recommended for sophisticated investors, this is not a full solution and is not likely to be viable for many paper certificate holders (it forces the use of a stockbroker with associated costs for example).

ShareSoc has already made representations to the Government on this matter and had meetings with other parties. We will be keeping a close eye on developments on this issue, but ShareSoc Members may wish to raise the matter with their M.P.s if they get the opportunity. It is a complex issue but it might have very wide ramifications. It is very important that whatever system is devised, it meets the needs of investors and of issuers (the companies who issue the shares), and not be focussed on the preferences or commercial interests of the intermediaries such as stockbrokers.

Roger Lawson, ShareSoc, 3/3/2013

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