

SHAREHOLDINGS

PART I INTRODUCTION

1. A share

A share represents the proportion of a company that the investor owns. Private shareholders can hold these either as a:

- Legal shareholder; thereby being a full member of the company.
- Beneficial owner of shares which, are held in nominee accounts

2. Legal shareholding

This can be recognised by holding a share certificates or by personal membership of CREST. In the latter the individual shareholdings are stored electronically and the shareholder receives a regular notification of all his/her holdings in the account. Shares can be bought, transferred or sold.

2.1. Share certificates

The holder of share certificates is recognised as a member by the company. The shareholder therefore receives, free from fees, all the rights (see 5.1) due to a member including dividends. These shares can then be:

- Traded through any broker
- Transferred to a person of his/her choice

One disadvantage of this is the fact that a share certificate is a physical object which means it has to be:

- Kept safely
- Actually moved to another place when traded or transferred

2.2. Personal membership of CREST

This option disposes of the piece of paper, the share certificate, by holding it securely in electronic form within CREST. The shareholder is still the legal owner of the shares and is therefore a member of the company. However a sponsor is required who will be charged £10 per year for each sponsored member, which is normally passed onto the owner.

The sponsor may levy its own additional charge and the sponsored member will need to have trust in the sponsors honesty, integrity and competence. The sponsor (usually a broker) is regulated and is required (in principle) to have adequate insurance arrangements to protect the sponsored member from negligence, incompetence and fraud.

3. Beneficial ownership of shares

This system interposes a nominee manager between the company and the investor. These holdings are kept in a nominee account. The investor is NOT the legal owner of the shares and is not known to the company as a shareholder (member). This is the only option for PEPS, ISAs and SIPPs.

3.1. Nominee Accounts

The Nominee account manager is the legal owner and receives the share certificate (unless a dematerialised system has been set up) and passes on to the client the benefits from these shares (i.e. dividend and return of capital if interest is sold) via a nominee account. The client is therefore known as the beneficial owner of the shares and is totally reliant on the manager (the legal shareholder) for all the information and benefits from the company.

The nominee account manager may operate

- A designated account, which means each shareholders holdings are held separately.
- A pooled account whereby holdings are merged so that there should be a benefit from netting¹.

Nominee managers generally charge a fee for this work.

3.2. Corporate nominee accounts

A special type of nominee account is that run by or on behalf of the company concerned. In this case it is a relatively simple matter for the client to be recognised and receive most of the rights and benefits due to a member of the company. Some companies exploit this opportunity better than others. However there are legal restrictions that deter further development to this approach so the problems are similar to those of a nominee account.

4. Comment

The involvement of a third party with personal membership of CREST and nominee accounts will create cost implications. These costs will usually be born either by the shareholder or by the company.

The legal shareholder has more rights than the beneficial owner of shares

PART II THE PROCESS AND DRIVERS FOR CHANGE

5. Certificated holdings

A share certificate is a piece of paper that includes:

- The name of the company
- The name/s of the registered holders (individual or joint ownership)
- The number of shares owned
- The name and address of the companies registrars

It will either be signed by two directors or given under the Securities Seal of the Company.

A UK resident has a legal right to own shares in this way in which case is legally regarded as a member of the company. They can also be used as a security.

5.1. Legal rights of a member of a company

A member of a company is entitled to:

- Receive
 - * Annual & interim reports
 - * Notice of AGM & resolutions to be presented there
 - * Rights issue documents
 - * Takeover and merger documents
 - * Other documents circulated to shareholders by the directors
 - * Documents circulated to shareholders by other parties (i.e. aggressors in a takeover).
- Submit or be signatory to members' resolutions
- Attend, speak or vote (including the show of hands) at AGMs and other meetings.
- Vote on resolutions by proxy

These documents can be bulky, complicated and difficult to read, but they are an important part of the information that is fed back to the shareholder.

5.2. A simplistic description of the transaction process

In simplistic terms share certificates must be moved from the selling shareholder to the broker, who passes this on to the share registrar. The registrar will then cancel the certificate and issue a new one in the buyers name and send it to the broker. The broker passes this onto the buying shareholder.

The deal can be started by post, phone, online or in person.

Non-commercial and other special transfers can be made directly with the share registrar using prescribed forms.

5.3. Keeping share certificates

Share certificates are valuable and are liable to being lost, mislaid or stolen. The investor can keep them in a safe place or deposit them with a third party (e.g. bank) for safety in which case there is likely to be a charge.

6. Driving change

The most common reason for investing in shares is to earn interest and to make a capital profit. It follows that investors select companies they consider have a good business plan, a capable management and are likely to earn a return on capital that will exceed that which could be obtained with a simple, less risky cash account. This objective can be assisted by:

- Facilitating the ability to sell or buy quickly
- Limiting costs
- Minimising the risk of default by the broker or some other party²

An additional consideration will be the tax treatment for shareholdings and the rules laid down by the Inland Revenue. Tax benefits are available in this respect by:

- Using PEP and ISA for tax free status; however these require the use of intermediaries (i.e. Nominee Accounts)
- Holding the share for specified periods, (e.g. to obtain taper relief) to accrue tax discounts

- Opting for joint shareholdings so that each investor's capital gains tax allowance is available

Two specific issues can be described:

- The costs of shifting paper around the country are rising and these costs, therefore, are targeted for reduction.
- A certificate takes time to be received, amended, authorised and redirected by the registrars. Sales of certificated shares in the period before a new certificate is issued are either inhibited or become too complicated, (e.g. day trading).

Improvements to the process can be achieved by using intermediaries and electronic systems.

In order to reduce the costs associated with these transactions, it is now London Stock Exchange policy to encourage the dematerialisation of share certificates by replacing them with either nominee³ accounts or personal membership of Crest. However, shareholders are still likely to require a written record of their shareholding and entitlements and this usually means the nominee administrator or sponsoring broker charges a fee.

7. Key issues

Key issues in trading or transferring are the:

- Speed of transaction
- Costs of process
- Security and legality of trade or transfer

A transaction consists of two distinct actions:

- Transfer of money (where it is involved) to the seller
- Transfer of shareholding to the recipient

In general a record or certificate that legally establishes as fact the transfer of money and shareholding will be provided.

7.1. Cost considerations

Broker charges can significantly reduce the overall return on investments in the long term particularly if they are based on a percentage of the holding of beneficial shareholders. A tie to a single broker prevents flow of business to more competitive providers by reducing competition.

Exit fees for individual shares or portfolio transfer can:

- Be used deliberately to inhibit competition
- Penalise savers for seeking the release of their own assets from the broker

7.2. Speed of transaction

Settlement of stock market transactions can range from transaction (T) + 25 for speculators to T + 0 for large institutions and international traders. There is always a risk of default in the period between the making and settling of a contract. Shortening the period reduces this risk. Lengthening it increases risk of default but can provide a useful position for shareholders who wish to bet on an increase or decrease in price.

Most settlements take T + 10 but there is a trend towards T + 5.

7.2.1. Transferring money

Cash is not normally used in share transactions because it is bulky, subject to theft and expensive to move from A to B.

Cheques can be sent via (first class) post or delivered by hand and will usually take at least four working days to clear once it has been paid into the brokers account. This should be adequate for a T + 10 provided there are no delays. The broker then passes the money on to the recipient.

Debit cards can be used in a similar manner but can be phoned or emailed through to the broker.

Direct debits provide the broker with the facility to take the money out of the buying shareholders account after an agreed period.

Electronic transfers of money systems need to be set up in a PC and can immediately transfer money to the brokers account.

7.2.2. Transferring shareholding to the recipient

Electronic transfer of electronically held shareholdings should be faster than the physical transfer of share certificates.

7.2.3. Supplying records or certificates

Money and ownership can be concluded electronically but most shareholders will need written confirmation of their deals so that they can be checked for accuracy and provide proof of ownership.

7.3. Cost of process

Certificated shareholders only pay the transaction fees and tax. Personal membership of CREST and nominee account holders also generally incurs an annual fee charged by the nominee administrator or sponsoring broker for managing their account.

Investors⁴ should carefully check both the transaction and management fees before deciding whether to remain with certificates or move to a dematerialised system. It is also likely that dematerialising certificates result in an increase of back-up pieces of paper relating to records of assets and transactions completed.

7.4. Security and legality of trade or transfer

Certificates are a good indication of legal ownership. No extra paperwork is required. However there is the risk of them being lost, mislaid or stolen.

Nominee administrators and sponsoring brokers may fail or default. The risk of their failure or default needs to be assessed in addition to the companies in which the shareholder has an

interest. These shareholders rely on regular statements to prove their ownership with a consequential increase in the amount of paperwork. Many PEPs & SIPPS now have assets far greater than the current minimum insurance levels.

7.4.1. The dividend and other payments

Dividend and other payments to certificated shareholders, which can either be paid by cheque or directed into the shareholders bank account and will, usually, come with a tax certificate. These comprise a single piece of paper. (Some companies have a system whereby the payments can be used to buy more shares in the company).

Where the account is maintained by a nominee manager or a sponsoring broker the dividend and other payments paperwork will often consist of several pages. The dividend will either be paid into the shareholders bank account or reinvested as previously agreed.

8. Share transactions

Change means that new ideas and technical advances for share transactions are offered and these bring their own advantages and disadvantages. It should also mean greater choice for the investor so that the best process can be selected for their particular circumstances.

8.1. Certificated holdings

A certificated shareholder (member of company) is able to buy or sell shares using any broker. The member can also transfer shares by contacting the registrar. The member will have all the rights listed in section 5.1

8.2. Personal membership in CREST

There are a number of disadvantages for the legal shareholder in CREST.

- Inability to trade via any other brokers
- Inability to trade during the transfer process of individual holdings or a portfolio to another broker
- Exit fees
- Risk of major delays in trading ability or loss of assets if the broker fails and assets have not been properly administered
- Broker fees generally

In addition there may be difficulty in:

- Having joint accounts
- Using the holding as a security

8.3. Nominee account shareholdings

There are a number of disadvantages for the shareholder in nominee accounts⁵.

- Effective loss of rights, (such as voting rights) as a member of the company
- Charges by the broker
 - * Fixed-price or percentage-based periodic fees
 - * Charges for dividend collection and/or release to the investor
 - * Charges for statements of account holdings & cash balances

- * Charges for exercising membership rights (if available)
- * Exit fees
- Inability to trade via any other brokers
- Inability to trade during the transfer process of individual holdings or a portfolio to another broker
- Risk of major delays in trading ability or loss of assets if the broker fails and assets have not been properly administered

In addition there may be difficulty in:

- Having joint accounts
- Using the holding as a security

9. UKSA view

Whilst change is an ongoing factor in share transactions there should be no loss of rights or increase in risk for the shareholder. There is nothing inherently wrong with share certificates; others find an advantage in moving to nominee accounts or personal membership of CREST. These choices should be retained. An ideal solution might be an electronic share certificate that exactly replicates the paper share certificate and allows joint holdings and the option to use them as a security.

Meanwhile, until a properly structured electronic account becomes available;

- Personal membership of CREST should be improved by removing the need for a sponsoring broker so that shareholders have their own personal (or joint) account.
- Beneficial ownership of shares should carry the same rights as legal shareholding and the companies involved should meet their costs of recognising these rights.
- Inland Revenue tax benefits should be applied to all types of shareholdings.

Private shareholders should, easily and simply, be able to:

- Select the best option for their current needs
- Move from one system to another

¹ An additional benefit and cost saving in that only the information concerning the balance of beneficial shareholder dealings need to be registered with the registrar (e.g. 100 sold, 110 bought, balance 10 which need to be registered as a change of legal shareholding with the registrar).

² Risk is an important issue but its qualification and quantification is beyond the scope of this paper.

³ The Inland Revenue is also currently forcing PEP, ISA and SIPP holders to use nominee accounts.

⁴ It is quite easy to make comparisons and an example follows based on a trading figure of £1000 per deal.

Investor A uses an online broker who only provides nominee accounts. Each deal is £9.95 plus a £50 fee per annum.

Number of deals per year	Annual management fee	Transaction fee (per £1K)	Total
One	£50	£9.95	£59.95
Two	£50	£19.90	£69.90
Ten	£50	£90.95	£140.95
Twenty	£50	£199.00	£249.00

Investor B uses a telephone broker who provides certificates. Each deal is charged at 1% of the cost of trade, which is £10 per deal for £1K. There is no annual fee.

Number of deals per year	Annual management fee	Transaction fee (£1K)	Total
One	Nil	£10.00	£10.00
Two	Nil	£20.00	£20.00
Ten	Nil	£100.00	£100.00
Twenty	Nil	£200.00	£200.00

NB. Since tax would be the same in both cases it has been discounted in these examples.

The point of these calculations is to show that online electronic dealing in a nominee account is not necessarily cheaper than telephone dealing in share certificates. However if there were twenty transactions at £2K then the fixed price online broker would still have costs of £249 but the telephone broker with a 1% fee would be £400.

⁵ Because of the very substantial costs Nominee managers are highly reluctant to send out the Corporate Governance paperwork. They may;

- Précis the information
- Send it on if requested (there may be a fee for this)