

Initial Observations on BIS Research Paper Number 261
Submitted by the UK Shareholders' Association Ltd

1. Generally speaking, the research firm (BDRC) has done a decent job, given that it had no previous experience of the subject it was investigating. Some of its findings do appear suspect, however, which may in part be a result of misunderstanding. For instance, the statement on page 41 that "*Many of those with paper certificates..... will have opted to receive these in digital format,*" reflects ignorance of what happens in practice, with investors suffering relentless pressure by registrars to relinquish their right to a printed report, which is easily done by default. More seriously, there appears to have been an over-readiness to take at face value what the researchers were told by those with commercial interests to protect. It is worth noting too, that some of its statistics are drawn, albeit necessarily, from unfortunately small samples – eg the 221 mentioned at the foot of page 27, deemed to represent one fifth of the entire population.
2. The statement on page 14, that, "*The Government wants to encourage better and greater shareholder engagement.....*" begs the question whether those in Government who have determined this objective properly understand that 'shareholder' – a term which this report does not define – relates only to those whose names are held on companies' share registers. Under British law, it excludes those whose money has been used to purchase shares held by a nominee, so the Government's aspiration is either (as we hope) misrepresented or (as we hope not) too limited.
3. The report also states (on page 14) that, "*Relationships between companies and investors consist of long chains of intermediaries.*" This should read '*can consist*', because investors holding paper certificates own their shares directly and are not dependent on intermediaries. The researchers elsewhere include share registrars among their definition of intermediaries, but this is surely mistaken because a registrar – which could be a member of the issuer's staff – is merely employed to record ownership, not to act as an intermediate owner. The same distinction surely applies to those whose shares are held electronically in sponsored Crest accounts, which merely supplement a registrar's own records.
4. The report contains many instances where brokers are recorded as expressing (as on page 15) "*a willingness to pass back (shareholder) rights and be unlikely to charge specifically for this,*" but in our experience these claims are by no means always borne out in practice; nor is this bland statement borne out by statements elsewhere in the report (eg on page 74). No mention is made in the document of the limitations or other difficulties suffered by investors when rights are 'passed back', such as the absence of readily available documentation and restricted time for decision making.
5. Similarly, brokers' comments (as reported on page 15 and elsewhere) that they "*did not perceive that their clients had any issues with pooled nominee accounts and they saw little appetite for voting or attending AGMs*" are wholly self-serving and not to be trusted (see paragraph five on page 49 for clear evidence of this). Not only do the reported comments ignore an increasing level of public complaint about the limitations of pooled nominee accounts (as can be found in the media), but they beg questions such as whether these limitations are adequately explained (if at all) when brokers seek their clients. For the Government, there is a bigger issue, which is whether sufficient is done to educate the public in the different ways of investing in equities and the opportunities which do exist for investors who are shareholders – ie do hold shares in their own names – to engage "*with companies in order to facilitate good corporate governance,*" namely the Government's objective stated on page 14.

6. With regard to the brokers' comments quoted above, the report adds, on page 15, that "*individual investors supported this to some extent..... and most had the level of engagement with companies that suited them,*" but this statement's qualifications should not be overlooked. There is widespread ignorance about the rights which shareholders should enjoy and many who are attracted to equity investing will simply accept what their chosen brokers provide. Apart from the UK's two private shareholder associations (neither of which receives any public funding), there is almost no source of information available to give investors and potential investors the information necessary to enable them to make an educated choice between different methods of investing. The UK Shareholders' Association has long complained about this. This is certainly reflected in the report, notably on page 16 and at the top of page 33 but also elsewhere.
7. The statement at the foot of page 16, that "*Institutional investors did not own or control shareholder rights, rather these were systematically distributed between different intermediaries in the chain,*" is of huge significance for the Government. It is surely clear that the *only* investors with a direct interest as shareholders and a shareholder's ability to engage directly with companies, are private investors who hold shares in their own names. All other investors are separated from their investments by intermediaries – both private investors using pooled nominee accounts and all institutional investors.
8. It is also clear from the report (as summarised on page 19) that intermediation is a *cause* of the low level of engagement by investors with companies. The law treats as shareholders only those whose names are on a company's share register, so when these are merely intermediaries the desired level of engagement cannot be expected.
9. Underlying consideration of how the shares purchased by private investors are actually held – and therefore what shareholder rights they may be able to exercise – is how free they are to choose. This has not really been addressed by the research, but arguably it should have been, as the reality is diminishing choice. The opportunity for private individuals to hold shares in their own names has been diminishing, which means fewer of them will find it easy and straightforward to obtain company reports, attend AGMs or vote – even by proxy. Fewer brokers will now deal in paper certificates even though higher charges are the norm, so these are mainly held by those who have been investing longest and are probably oldest. Few brokers will sponsor new personal CREST accounts –the number has in fact diminished by two since the research was conducted and one broker who once led the field for this service at £24 pa now charges £420 a year to provide it. ISA and SIPP investments, encouraged by successive governments, actually oblige the use of nominee accounts (the researchers seem to have missed this point) and despite HMRC regulations brokers are more or less free to handle these how they like, including making whatever charges they choose.
10. When annual reports, AGM notices, proxy voting cards and other material come directly to investors through the post, with 21 or even 14 days' notice, it is relatively easy to decide whether to attend a meeting or vote by proxy, but in the absence of these materials, or with shorter notice it is more difficult; it is not the case that the date of an AGM is always "*shown in an annual report*" (page 81) and AGMs are not the only meetings of importance to investors. Not all investors live in London and attending a company meeting can require planning, including taking time off work. Voting without having the appropriate information available is hardly an intelligent exercise, but obtaining it when shares are held by a nominee can be too much of an effort. Only name on register puts an investor in the position Parliament intended by passing the Companies Act 2006.

11. Page 73 states, with a major qualification, that "*brokers were willing to pass back rights 'on request'*" and then goes on to state, as though with authority, that, "*it is also important to note that annual reports are easily accessible via company websites and can be accessed and printed if needed.*" This is naive. Whereas an institutional investor may think nothing of printing a company report, a private investor sitting at home is likely to find this prohibitively expensive except for a very small number of investments. Reading reports on a domestic screen is also frequently less easy than it sounds, for several reasons which readily become apparent when tried.
12. The 'on request' proviso is mentioned again on page 74 in connection with attendance at meetings: how do brokers define the term – must a request be made every time, or will standing requests be accepted? In this section the report states that 'most' brokers charge a fee for this, which is not the impression given elsewhere in the report, but the charge of £20 which is suggested would prove prohibitive for many with a diversified portfolio, especially when added to the cost of actually attending AGMs. Here, as elsewhere in the report where brokers' practices are being commented on, the evidence seems flimsy at best and often little more than anonymous hearsay; it cannot be relied upon.
13. Information on the London Stock Exchange website obtained through the link provided on page 75 is seriously misleading when it states, "*Nominee accounts are ring-fenced from brokers' other activities so they are financially secure.*" This only applies if brokers faithfully follow the rules, but sometimes they don't and then investors suffer at best a long delay to get access to their investments and, at worst, loss of all value exceeding £50,000 (which many investors would not regard as "*an awful lot of money*" as one broker is quoted as suggesting on page 79) . This is not spelled out by the LSE nor by the report, but it should be. Page 76 reveals that one broker in eight (a significant 12.5%) claims the right to lend its clients' shares to third parties, thus substantially increasing the counterparty risk associated with pooled nominee accounts.
14. The failure of more brokers to provide sponsored CREST accounts and their preference for pooled nominee accounts has not been adequately investigated by the researchers; it would appear, for example, that Euroclear (the provider of CREST) was not interviewed. A sponsored CREST account enables an individual investor to enjoy all the shareholder rights provided by Parliament; a pooled nominee account gives him or her none of these. A sponsored CREST account can be moved from one broker to another without charge, but to transfer shares held in a pooled nominee account is expensive and there is evidence that some brokers exploit this.
15. The final pages of the Individual Investor section of the report, to page 84, are full of comments that illustrate how brokers pursue their commercial interests without much regard for their clients' potential interest in behaving as responsible owners. Some display a rather patronising attitude, or even quite marked feelings of contempt towards those clients. It is difficult to avoid the conclusion that current commercial interests and practices are in conflict with the exercise of shareholder rights as intended by Parliament in the Companies Act and that this needs to be addressed if individual investors are to play their part in providing the "*better and greater shareholder engagement with companies in order to facilitate good corporate governance.*"

Eric Chalker, Policy Director, 19 February 2016