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UKSA's Views on Nominee Shareholder Enfranchisement and Background Information on Shareholder Rights

There have been a number of meetings of the Shareholder Rights Working Party that was set up subsequent to the publication of a document by the European Securities Forum (ESF) – see below. Without going into the details of the discussions, to which the UK Shareholders Association (UKSA) was a party, it is clear at this time that no comprehensive system for enfranchising shareholders has been devised and agreed.

The UK Shareholders Association originally expressed support for the proposals on shareholder rights for nominee accounts as outlined by the ESF and supported by the Company Law Reform White Paper. It has clearly been a major concern of our members that shareholders in nominee accounts are generally ill informed, and lose the basic rights enjoyed by shareholders whose name is on the share register. But it is now clear to us that without more vigorous government intervention in this matter, no satisfactory solution is likely to appear.

Particularly the failure to get any agreement on a simple, comprehensive and practical system to implement the principles will in our view fatally undermine the provision of the required rights for shareholders in nominee accounts. Regrettably, the needs and rights of the shareholders themselves seem to have been overlooked in the bickering about costs and obligations imposed on the industry service providers.

Let us explain the above in some more detail:

1. The Original Concept.

The original ESF document published in December 2004 and entitled "Better, Quicker and More Efficient Arrangements for the Individual Shareholder" said in para 4.2.1 that *"…we propose that investors who choose to use a nominee company as a vehicle for their investment should also be enfranchised as if they held full legal title (their own name on the register)"*. This was supported by the Company Law Reform White Paper which refers in section 3.2 to the extension of "governance rights" to indirect investors and the "right to information" for such investors.

2. What We May Get

But the solution that has been developed has the following primary features:

A – Companies will need to amend their Articles to support governance (e.g. voting rights), which is optional, and it seems quite likely that many if not most, may not do so.

B – It is not even clear whether companies will have an obligation to provide information such as the Annual Reports & Accounts in any form as this requirement is only embodied in a reserve power of the Government in the new Bill. There is no commitment to use this power at all, and it does not even provide a right enforceable in law by shareholders.

C – The Company Law Reform Bill proposes that companies can choose which rights they actually offer such indirect shareholders, so that some companies might chose to offer just information, others may offer voting rights but not rights such as the ability to call for an EGM, while yet others might offer full rights. It is up to the companies to choose which rights, if any, they give beneficial shareholders by changes to their Articles.

D – In addition, it will be optional for brokers and/or other operators of nominee accounts to support the Companies in the provision of such rights to their beneficial shareholders. Indeed only certain brokers seem to have much interest in this, while other brokers suggest they already have adequate facilities, for which there is no demand anyway. However, it is clear that any brokers offering such facilities will be likely to make some extra charge to cover their own additional costs of providing such information or supporting voting systems.

In summary we have a proposed system which is probably going to have little take-up by brokers, is unenthusiastically supported by companies and in which registrars have no interest (except to minimise their own expenditure of effort in supporting the system). Perhaps it's not surprising there has been no unanimity on how it should operate!

In addition, brokers expect to incur costs in implementing any solution which they will pass on to the shareholders, instead of the issuers taking on that liability in full. This will discourage take-up of the facility by brokers' customers.

3. Exercising Voting Rights

One proposal that has been made is that the exercising of voting rights should continue to be handled by nominee account operators (eg. stockbrokers), who would aggregate their beneficial holders' instructions. But this assumes that existing mechanisms for doing that actually work, when in practice they do not. And at best it provides a mechanism for enabling a beneficial shareholder to express their preferences via the nominee account operator exercising their proxy votes.

However, this is very different to really "enfranchising" the shareholder, and it would certainly not enable a beneficial holder to attend and vote personally at a company General Meeting.

In reality, separating the flow of information from the company to the investor, from the return of voting instructions seems odd to say the least, and will lead to enormous practical difficulties, as it does at present for those brokers who attempt to support such a system.

Will all beneficial shareholders know when to vote, and what they might be voting about? Will brokers actually pass on the required voting instructions to their clients in a timely and reliable manner?

4. Cost to Issuers

It has always been anticipated that the issuers (ie. "listed" companies) would incur substantial extra costs as a result of the "enfranchising" of their indirect shareholders. However, the emphasis on electronic communication, as promoted by the Company Law White Paper and the subsequent Bill, will of course enable them to save substantial sums of money from cutting out the needless distribution of paper Reports & Accounts. There was surely an implied "deal" here that companies would take on the obligation of enfranchising their indirect shareholders in return for other cost savings. But it seems from recent comments by some parties that companies might well renege on this implied agreement. For example it has been suggested that companies might simply choose to provide information to such shareholders, but nothing else. In reality of course, there is nothing that would stop them doing so.

5. Shareholders Will Not Be Clear on their Rights

Because different companies may or may not enfranchise shareholders, and may indeed provide different levels of support for various rights, and brokers might also offer different levels of support, it will be totally confusing as to what rights an indirect shareholder might receive. Is a shareholder who might have many shares in his portfolio really expected to keep track of what rights he might or might not have in each? As a registered shareholder you always know what you should be receiving, and can easily double check for any missing notice of a General Meeting. But that will not be the case for indirect shareholders. In essence, the proposed system will simply be a mess.

Compare that with the US system where all indirect shareholders receive all information from all their investments as a matter of right, and also receive any required proxy voting forms in the same way. In essence, a simple yet comprehensive system, and truly a system that operates in the best interest of shareholders rather than the industry service providers and the issuing companies.

6. Over Complex and Impractical Solutions Instead of a Simple Principle

Unfortunately no agreement has been reached on how to enfranchise shareholders and most of the proposals have been complex to implement and not comprehensive.

Indeed what we suggested in our comments on the Company Law Reform White Paper were "We are not clear why the chosen route towards enfranchisement is the complicated one of (partially) enabling nominees to assign 'all or any specified rights', instead of the more direct route of legislating that the beneficial holders through the nominee accounts of registered brokers are ipso facto enfranchised, with all the rights of an on-the-register shareholder".

We see no reason why such indirect shareholders should not simply be recorded on the share register as additional members in the same way as "designated" nominees are, and it does not seem to us to be beyond the capabilities of modern technology to support such a system at no significant additional cost. Alternatively a central national register of indirect holdings could be maintained on a real time basis by co-ordinated activity by nominee operators. But it certainly depends on the willingness of brokers to disclose who

their clients are to the registrars or another central body and ensure that they reconcile with the “pooled” totals of shares held and the associated voting rights on the registers.

But clearly one difficulty is the lack of any enforcement or encouragement in the Company Law Reform Bill to persuade brokers and issuers to participate in such a scheme. The proposed changes to Company Law, which appear to have been designed purely to facilitate an agreed industry or market-based solution, will in practice not be sufficient with the existing attitudes of industry participants to effect any substantial change and ensure most indirect shareholders are enfranchised in a reasonable time frame.

7. Time to Reconsider

In summary, we think it is time to reconsider this whole area of shareholder enfranchisement and start again with a much stronger commitment from both the industry participants and the Government to support a more universal system of enfranchisement, supported by simple operational systems.

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Note: the relevant clauses of the Company Law Reform Bill are 136 and 137 in Chapter 3 Part 9.