

The Private Investor: March 2012

An end to share certificates?

As reported in January, one of the ways in which UKSA's policy activists are currently seeking to protect and promote private shareholders interests is through participation in a working party preparing for the expected end of paper share certificates. This group was established jointly by the Treasury and the ministry known as BIS (Business, Innovation & Skills) run by Vince Cable. Its specific purpose is to assist the government in its response to a draft EU Regulation *on improving securities settlement in the European Union and on central securities depositories (CSDs)*.

CSDs are well known on the continent, but while the CREST service provided by Euroclear may come close it appears that the UK has nothing which quite fits the description, so some changes to UK arrangements will be required. One of these is 'dematerialisation', also known as 'immobilisation'. What these terms mean is that all shareholdings become 'book entries' within a specified CSD. The proposed target date is January 1, 2018.

The European Commission's proposal can be found at http://ec.europa.eu/internal_market/financial-markets/central_securities_depositories_en.htm. Its stated motivation is to address "the lack of safety and efficiency of securities settlement", especially with regard to cross-border transactions within the EU.

To do this, it sees the need to introduce "a set of common rules concerning certain aspects of the settlement cycle and discipline". One of its proposed requirements is a T+2 settlement period, which is not only a day faster than currently applies in the UK (and elsewhere, including the USA), but would appear to remove the discretion now available to brokers to allow longer periods to suit client requirements. This requirement, of course, is the fundamental reason for imposing dematerialisation, as the movement of paper certificates would make such a short settlement period impossible.

The Financial Times carried the story in an oblique form earlier this month, under the headline, "Fight to save share certificates", quoting EU officials as claiming that "millions of pounds" of investments have been lost by "termites and other household insects" eating the certificates. One wonders how they know. Another Brussels quotation was that UK lobbying to retain certificates was "all for the grannies", as though the interests of pensioners should be irrelevant, but of course they are not.

It is difficult to quarrel with the Commission's initiative, especially in the context of unimpeded cross-border investing implied by any common market. What matters is how it is to function and how it is to be implemented. Most fundamental of all to UKSA is how this will affect share ownership.

The Commission itself states, "It is important to establish clear rules on the law applicable to ownership aspects in relation to the securities that are maintained by a CSD in its accounts" and "the applicable law should be the law of the place where the accounts of a CSD are maintained." So UK law will prevail — if the shares have been issued by a company using a UK CSD. However, all companies will be free to choose a CSD anywhere in the EU, which suggests that shares purchased by the same method in different companies might result in different ownership rights if their CSDs are in different countries.

Those, being grannies or not, who currently choose to hold paper certificates, enjoy full ownership rights over their shares, so the question arises, how will retention of those rights be preserved once the shares are dematerialised? As things stand, if they are shoved into a nominee account those rights will be immediately extinguished, because, contrary to what some believe, the legal ownership of shares in a nominee account belongs to the nominee and not to the investor; the investor enjoys the beneficial rights only, plus whatever the nominee allows in its terms and conditions. The only way, at present, of being the legal owner of one's equity investments if they are not held in paper form is through a personal CREST account.

At present, a personal CREST account can only be obtained through the sponsorship of a stockbroker or other authorised user of CREST. Not all brokers provide this service and those that do can charge what they like. UKSA must press for the right of all investors to retain full legal rights over their investments after dematerialisation and must use this opportunity to press for this facility to be available to all equity investors, including those investing through ISAs and SIPPs. This is really the only certain way to protect one's investments and secure better corporate governance.

Notes

- the above is a selected article from the March 2012 edition of *The Private Investor*, the UKSA members' newsletter
- a selection of previous editions of *The Private Investor* have been made available to non-members here: <http://www.uksa.org/public/publications/tpi>
- The UK Shareholders' Association (UKSA) is a not-for-profit company, limited by guarantee.
- UKSA campaigns to protect the rights of private shareholders in public companies and promote improved standards of corporate governance.
- UKSA was established in 1992.

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