Share ownership – a paper by Nick Steiner

UKSA met with registrars on 2 October 2017 to consider the document entitled 'An Industry Proposed Model for Dematerialisation' (*see also Eric Chalker's article on page 5).* The following exchange goes to the heart of the issue:

UKSA's question: Why can't the share certificate, which starts dematerialised, remain dematerialised? Why can't it be sent electronically rather than be printed in the registrar's office?

Registrars' answer: Crest regulations require it to be printed out and sent. There are also a number (at least 16) of applicable and best practice guidance documents that need assessing before a change can be made. Due to pressure of other work the earliest BEIS can complete this work is 2021. We all find this very frustrating, but:

- Any change in the system is enormously more complicated than you are assuming;
- The registrars have a proposal that they are progressing to achieve what you want but it's bound to take a long time because of politics, special interests, complexity and Brexit;
- The registrars are enormously supportive of dematerialisation of share certificates.

It is clear that the registrars and companies would like this legacy issue resolved. It is costing private shareholders a lot of unnecessary money and is wasting time. BEIS have shelved this issue while they deal with Brexit. This is unfair; letters to MPs and further pressure from us could help to unlock this unjust system!

The background to share ownership

The London Stock Exchange says: "*Shares are often surrounded by mystique but the principle behind them is simple and straightforward. Shares, also known as equities, provide you with part-ownership of a company so when you invest in shares; you are buying 'a share' of that business. Companies issue shares to raise money and investors buy shares in a business because they believe the company will do well and they want to 'share' in its success.*

*Companies do not have to be quoted on the stock market to issue shares. When businesses start out, many of them raise money from outside investors, who are given a share of the company in return. These investors tend to be friends, family or benefactors and their shares are known as unquoted because the companies are not listed on any stock market. Even if a company states that it is a '**PLC**' (Public Limited Company), it does not necessarily mean it is listed on a Stock Exchange. This is just a legal status for the company.*

When a company wants to raise money more widely, it can apply to become publicly listed or quoted on an exchange, such as the London Stock Exchange. Once it has gone through the approval process the company then has its shares admitted to trading on an exchange and its shares can be bought by individual investors and large, investing institutions, such as pension funds and life assurers. Companies have to satisfy certain legal and financial criteria before their shares can be listed on a stock market and the shares are known as quoted because their prices are quoted every day on a stock exchange.

Owning shares in a company means that you are entitled to a say in its affairs. All PLCs have annual meetings, where shareholders vote on matters such as the company's accounts, directors' appointments and pay packages. Companies also hold meetings for shareholders when they are about to make big changes to their business, such as buying or selling parts of the company or raising fresh capital. Trading in shares is executed by stockbrokers, who buy and sell shares on behalf of investors. Increasingly, investors buy shares over the internet, using online broking services."

Most share owners have share certificates and these have difficult legacy issues examined later in this paper.

Members

If your name is on the share register generally kept by the company's registrar, you are a member of the company and have the following rights and benefits:

a) Attend general meetings, appoint a proxy, ask questions;
b) Receive all communications direct from the Issuer;
c) Exercise rights for both Voting & Corporate Actions directly without the imposition of artificial deadlines;
d) Compliance with terms and conditions set by national law and articles of association;
e) Trading options; you are free to use a broker of your choice, facilitating competition;
f) Few foreign ownership barriers compared to nominee arrangements;
g) Cost – Issuers do not charge shareholders for the privilege of being members.

'Name-on-register' and 'registered shareholder' are both considered Members. A person or persons holding an interest via a nominee arrangement is not a registered member but an 'underlying member/holder' or a 'beneficial holder' (common phrases to identify this sub group of holders). Some rights can be conveyed via the Beneficial Holder Information Rights (or BHIR process) but that itself relies on the nominee providing the registrar or issuer with accurate information on the beneficiary and the resulting outward information is limited only to the provision of notices or reports (not direct voting or dividend rights).

Nominee managers

If you elect to use a nominee manager you don't own the shares but become what is known as a beneficiary of the shares. The nominee manager is the owner and chooses, often by levying a fee to pass on some of the members rights.

An examination of the law behind the current process of buying and selling share certificates

Key information:

1) A share **certificate** is a certificate issued by a company certifying that on the date the certificate is issued a certain person is the registered owner of shares in the company.
2) A share certificate (in England under seal) is *prima facie* evidence (in Scotland 'sufficient evidence unless the contrary is shown') of the member's title to the shares: CA 2006, sec 768).
3) The information contained in the share certificate has been reduced (e.g. address of shareholder is omitted).
4) Shares may be transferred by means of an instrument of transfer in any usual form or any other form approved by the directors, which is executed by or on behalf of the transferor.
5) Most companies will require the share certificate to be produced when a request is made to transfer shares.

The share register is in digital format. Contract notes are set up digitally and can be sent online. Share certificates are set up digitally, printed out (materialised), couriered to broker and then put in an envelope and sent by post to the shareholder. It is the least important of the three items but incurs the greatest cost.

In both of the situations below shareholders were simply sent new certificates to replace the old ones which are now worthless:

1) The growing popularity of takeovers by schemes of arrangement, at least in part, is due to the removal of the need for return of share certificates. A good example is the Shell takeover of BG.
2) Share consolidations are another example of the removal of the need for a return of share certificates. Examples are the RSA and National Grid consolidations.

Share ownership is recorded in the share register. Any dispute on entries would be referenced back to the share register and proof of transfer/trade provided by the investors/brokers. In theory, the opportunity could be taken for companies to issue digital certificates (see 4 above) recording that a sale or purchase of X number of shares has been made and the total holding is Y shares. (A digital certificate can still be printed out as with current procedure and this covers individuals with no access to a computer.) This 'certificate' would cease to be valid the next time shares in the same company are transacted and a new 'certificate' is issued. The function of the market for certificated holdings currently relies upon the recognition of a valid share certificate. A change such as this would require market adoption. It is likely that brokers are more interested in increasing nominee accounts, where they own the shares, since any improvement of the share certificate process may lead to loss of clients. So from their point of view there is an incentive in doing nothing.

Transferring shares without paper certificates (a proposal)

Share ownership is recorded in the share register. Key information concerning the share owner is:

a) Full name;
b) Shareholder reference number (SRN);
c) Number of shares.

The current address will also be recorded. The electronic certificate is a record of the number of shares owned on the date shown, so any new transaction results in a new electronic certificate and the previous electronic certificate can be destroyed. In order to buy and sell shares an account needs to be set up between both parties. The parties are the broker and an individual or a group.

Share purchase

The buyer contacts the broker. Agrees the price and arranges to pay in two days. If topping up, the SRN will be passed over. A contract note is issued by the broker. The registrar sends out a combined electronic certificate stating:

a) Name
b) The number of shares bought
c) Date of purchase
d) Total number of shares now held
e) SRN

This electronic certificate can be printed out at any stage for any buyer without a computer.

Share sale

Seller contacts broker. Agrees price and passes over SRN. A contract note is issued by broker. Seller sends signed electronic transfer form. Payment is made in 2 days after transfer has been completed. The registrar issues a combined electronic certificate stating:

a) Name
b) The number of shares sold
c) Date of purchase
d) Total number of shares now held
e) SRN

This electronic certificate can be printed out at any stage for any buyer without a computer.

Advantages

This new system does away with a paper certificate that is only prima facie evidence of ownership. The key piece of information is the SRN. Currently this piece of paper trundles through the postal system long after the deal is done when buying and simply delays deal completion on sales. It also is given unmerited status in that a lost certificate requires indemnity forms and cost of replacement. Market adoption should be straightforward and result in cost and hassle savings all round.