TheCityUK

TheCityUK feedback to the Digitisation Taskforce Interim Report

Introduction

TheCityUK is the industry-led body representing UK-based financial and related professional services (FRPS). We champion and support the success of the ecosystem, and thereby our members, promoting policies in the UK, across Europe and internationally that drive competitiveness, support job creation and enable long-term economic growth. The industry contributes over 12% of the UK's total economic output and employs nearly 2.5 million people, with two-thirds of these jobs outside London, across the country's regions and nations. It is the UK's largest net exporting industry and generates a trade surplus exceeding that of all other net exporting industries combined. It is also the largest taxpayer and makes a real difference to people in their daily lives, helping them save for the future, buy a home, invest in a business and protect and manage risk.

We believe that the reforms proposed by the Taskforce are long overdue and the UK has the opportunity to create a modern infrastructure for share ownership that allows the UK to catch up and leapfrog other jurisdictions to compete successfully on the global stage. Further, we acknowledge that the reforms should be implemented in such a way as to protect shareholder rights and provide avenues for improved shareholder engagement with listed issuers, and at the same time be cost effective for both issuers and shareholders.

It is also our view that:

1. Reform to the share registry system should be in an open architecture that promotes competition and builds on the UK's strengths as an innovator in Open Banking, dovetailing with forthcoming developments in financial data exchange and digital ID.

2. Dematerialisation and digitisation should preserve the efficiencies that are present in the UK's securities holding model, including the use of omnibus nominee accounts, while leveraging technology to achieve permissioned transparency of ultimate beneficial ownership where possible.

3. Simplicity will be key; we do not want a scenario where six different shares once dematerialised result in six different portals and passwords as this will be challenging for those who are less experienced with new technologies.

4. Setting out market entry criteria and other contractual requirements and deliverables for each nominee is vital.

5. The Government should lead a public communications campaign to support retail investors and small businesses in the digitisation process, with close collaboration

between public authorities and financial sector firms and issuers with touchpoints with these stakeholder groups.

6. The opportunity to modernise the UK's approach in this area should not be lost and the Digitisation Taskforce should gather data on the costs (actual or perceived) of maintaining the status quo.

7. Certainty related to the end goal will enable the industry to begin investment in a dematerialisation transition and the envisioned modernised architecture.

8. Any adopted model ought to be appropriately attentive to shareholder rights, in particular those of retail certificated holders whose formal position as 'name-on-register' shareholders may change. In the next phase of the consultation, it will be important to understand in detail the substantive rights that retail shareholders wish to exercise under a new system, and how those can best be facilitated in the context of modernisation.

The move towards a single digital register maintained by the central depository will remove the duplicative and antiquated practices that render the UK out of step with international best practice. Removing friction will allow shareholders to trade their securities more easily and will assist with meeting the goals set out in the Secondary Capital Raising Review of facilitating issuers in raising further equity capital more easily.

The reference to the possibility of deploying Distributed Ledger Technology (DLT) in the future is welcome, and we agree that we should press ahead with reforms now and consider DLT at a future date. It is appropriate that the UK learn the lessons of the failed Australian deployment of DLT. The industry looks forward to working on stepwise approaches through vehicles like the Financial Market Infrastructure (FMI) Sandbox to determine the potential of the most fruitful use of this technology in capital markets.

Our responses below focus on the principles we believe should be followed to achieve the required reforms rather than the technical detail. Granularity (in particular, identifying any primary and secondary statutory changes necessary) is an important next step. Our view is that these principles can be achieved through Digitisation Taskforce's preferred model, where all shares are held in a single CSD, and intermediated and administered through a nominee.

Responses to questions posed in report

Question 1 – what would be an appropriate timeline to require all share certificates to be dematerialised to ensure that the communication arrangements necessary to allow previously certificated shareholders to have access to their rights are in place?

The timeline for operational dematerialisation will have to take into account the legislative timescales, the need to educate market participants of the proposed changes and requirement for the nominees to build the infrastructure that is needed. However, reform is necessary and we are in favour of implementing reform as soon as possible.

At the most, we recommend a timeframe of 18-24 months. This will allow legislation to be enacted, shareholders to have received communications over two Annual Report cycles, and give ample time for a government campaign to raise awareness. This will also allow retail shareholders to assess the market and choose their nominee and for nominees to prepare for the new regime, and for market entrants to invest in new products.

However, where possible, there must be a concerted effort to expedite this timeframe. The interim report recommends that 'Legislation should be brought forward […] as soon as *practicable* to stop the issuance of new paper share certificates' (emphasis added). Greater urgency is needed here. The UK market is already behind the curve on this compared to other jurisdictions, and this reform will play an important role in improving the market's global competitiveness.

Question 2 – What approach should be taken to the disposition of residual paper shares, and should a time limit be imposed for identifying untraced UBOs?

The approach should be predicated on initial steps to minimise the number of residual paper shares in circulation, including 'turning off the tap' and encouraging traceable UBOs to dematerialise. In other jurisdictions this process has been supported by a public communications campaign to underline the risks associated with paper shares, and industry initiatives to encourage dematerialisation.

We believe that a time limit should be imposed that is sufficiently generous to allow shareholders opportunity, following efforts to contact them and the public communications campaign, to educate themselves as to the new system and dematerialise their shares. The time limit should be agreed through a consultation process. Once this time limit has elapsed, one approach would be for a dedicated nominee or registered account to hold residual UBO holdings and after a further period transfer them to a dormant assets scheme.

There will be UBOs who, for whatever reason, cannot meet a nominee's KYC ('know your customer') requirements or do not provide the documentation. Consideration should be

given as to whether shares held by such people can nevertheless be dematerialised and held by a dedicated nominee.

Question 3 – with regard to 'residual' certificated shareholdings attributable to uncontactable shareholders, do you support each issuer having the option to manage these residual interests themselves within the authority contained within their articles of association as well as having the option to transfer the proceeds of sale to the UK's Dormant Assets Scheme?

Yes. Issuers should be permitted to manage residual interests and untraced shareholders. Many issuers already have forfeiture clauses in their articles for shareholders who have been lost for 6-12 years.

Question 4 – is the ability to have digitised shareholdings held on a register outside the CSD important to issuers or UBOs?

We support the consolidation of shares into one central digital register. The globally accepted best practice is to hold shares in a central depository and this is already the case for 99% of the value of holdings in FTSE350 companies.

If there are perceived benefits to being on a register outside a CSD then it is likely to derive from the small minority of direct retail shareholders who want to have the option to hold shares in such a way that their name appears directly on the company register and thus feel directly connected with the issuer.

We recommend that retail shareholders should be consulted directly on this point to determine how widespread this sentiment is, as the industry investigates streamlined means of achieving name-on-register holding models that are consistent with the overall preferred model identified by the Taskforce. However, whilst "Model 3" will mean that individuals will not have the right to be named on the register, we believe that there is no reason why within the proposed reforms their rights and their ability to use those rights, cannot be protected or even enhanced. Any consultative process with retail investors should be clear on the rights that they will have, to avoid any potential misunderstanding regarding their access to and ability to exercise their rights.

Question 5 – do you agree with the taskforce recommendation that the optimal architecture is for all digitised shareholdings to be recorded in the CSD and managed and administered through nominees?

We broadly agree with this recommendation to bring the UK in line with many other successful developed financial markets; an architecture of this nature should by design be

open, with a view to Open Finance and Smart Data initiatives, including future digital identity service providers.

A single digital register with nominees as legal owners is also the path of least resistance to digitisation. The model already exists and over 95% of capital is already held in this way.

As discussed above, we would caveat that the biggest impact of digitisation will be on the cohort of individuals who hold their shares directly; while estimates vary, this may impact over a million investors. We believe that shareholders who currently hold paper share certificates will benefit in the long run from a reduction in the risk associated with paper share certificates (including high costs) when they look to transfer their shares or regain access to them in the case of lost paper certificates. They will furthermore benefit from the companies they invest in enjoying a more efficient and effective environment to communicate with their shareholder base. Given the potential frictions for shareholders holding paper share certificates during any transitional period, the following issues should be considered:

1. The likely charges to investors associated with the receipt of documentation from the issuer, the attendance and participation at general meetings, both of which are currently paid for by the issuer, and also other costs charged by nominees for holding the shares on behalf of the individual including in relation to the payment of dividends to those individuals. It is important that these costs are not disproportionate and do not act as a deterrent to investing in the equity markets.

2. The impact on international shareholders of UK securities. We recommend an analysis be completed on the implications for holders of paper share certificates who are not resident in the UK (for example, nominees may not be recognised in other regimes, or it may be too difficult to find one who is willing to act for a shareholder who is outside the UK). If this were the case, it is not clear how they would be able to dematerialise existing holdings or receive new shares.

3. The legal implications of migrating from direct to beneficial ownership and the implications of each under UK law.

4. The KYC pipeline in respect of transferring millions of shareholders who hold paper share certificates to an electronic nominee ownership structure. The timing of the implementation of related reforms around digital ID and digital access to information should also be considered, as alternative vehicles for this change.

5. The process for nominees to dematerialise stock. At present nominees would need to receive the actual paper certificates before dematerialising them, but many of these certificates are likely to be lost and would need to be reissued. We recommend that this process be streamlined.

6. Further work is needed on the impact on branch registers (see comments in recommendation 2 below and internationally/dual listed shares) and certain types of dual listed securities.

Question 6 – do you agree that the dematerialisation of current certificated holdings would be optimally pursued in a two-stage process, first to dematerialise to a single nominee (which could be sponsored by the issuer, an intermediary acting on its behalf or a collective industry nominee) and second to allow individual participants to move their beneficial interests to a nominee of their choice electronically?

Shareholders with share certificates should be given sufficient warning prior to any wholesale dematerialisation of residual certificated holdings to allow them to place them with the nominee of their choice. However, after a certain time, we believe it is right this be undertaken in a phased manner.

It is our view that after certificated shareholders have been given sufficient warning, all shares should be dematerialised to a collective industry nominee. This is for two key reasons:

1. If a shareholder holds shares with a number of issuers, it would be far easier for that shareholder to interact with just one nominee.

2. Assuming these shareholders have been unresponsive to initial requests to dematerialise their shares, a nominee will be unable to obtain the requisite KYC information to hold the shares on their behalf. The collective industry nominee should be permitted to dematerialise the shares if it was unable to KYC the certificated shareholder. Further, we suggest leveraging the Open Banking ecosystem for domestic shareholders without requiring all usual checks. We also recommend an analysis of how to achieve this migration without the overwhelming challenge of performing millions of KYC checks.

Question 7 – do you agree that facilitation of shareholder rights should be left to market forces, with full transparency as to whether access to such rights is available and where it is, clear communication around ease of access and charges allowing shareholders to choose between full service or lighter touch models?

We are conscious that the recommended model results in shareholders no longer having the option to hold physical paper share certificates and enjoy what may be perceived at the moment as “free” shareholder rights (these are, in practice, subsidised by intermediated shareholders). It is therefore important that the Digitisation Taskforce provides clear guidance on the minimum services that nominees must offer UBOs including a baseline service of holding the shares, receiving dividends, receipt of all shareholder communications

and the ability to attend and participate at company general meetings. UBOs should, however, be able to opt out of these services if they wish to pay lower costs and have no interest in voting their shares or receiving communications from the issuer. We do not think it should be left to the market to decide minimum service levels.

There may be more upfront cost to certified holders than is currently the case. However, we would note that certificated shareholders do currently incur both direct costs when they seek to transfer their shares and indirect costs due to the costs to the issuers of dealing with them directly. The report notes that three major retail focused platforms have not charged to include voting rights, but there are charges for holding shares. As is the case in other jurisdictions, there could be opportunity for diverse low-cost platform models to emerge which would provide certain services for free.

Question 8 – What should the service level agreement be between issuers and the intermediation chain, with regard to the provision of UBO information? With regard to turnaround time and the frequency of request, what would constitute 'fair usage' of that process – essentially a 'baseline' obligation? Should aggregation be permitted such that individual UBOs below a minimum percentage ownership need only be communicated in aggregate; what should that percentage be?

We agree that there should be agreed market practices and standards but are not certain that it should take the form of a service level agreement.

We would also suggest that to benefit from digitisation, the systems could be built such that data is automatically collected and reports would be available in real time. This would be more manageable than having multiple issuers requesting reports from different intermediaries.

If an automatic solution is not possible, an on-demand digital version of s793 of the Companies Act 2006 should be developed, aligned to the shareholder disclosure requirements embedded within the Shareholder Rights Directive.

Question 9 – do you agree that only issuers should have the ability to access information below the level of what is recorded on the company's share register? Should there be restrictions on how issuers can use that information, including sharing the information?

We agree that only issuers should have the ability to access information below the level of what is recorded on the company's share register, noting that finding means to deliver outcomes associated with the 'proper purpose' test that facilitates investor activism ought to be considered. We also recommend that there should be restrictions on how the information is used and whether the information can be shared beyond the issuer to agents or regulators. However, we acknowledge that issuers must have the capability to share this

information with their financial and legal advisors under non-disclosure agreements, and for specified used to get proper advice around corporate actions.

Reflections on the report's recommendations

Recommendation 1 – legislation should be brought forward, and company articles of association changed, as soon as practicable to stop the issuance of new paper share certificates.

We agree with the recommendation. There will need to be careful consideration of how best to 'turn off the tap' of certificated issuance as well as having carve-outs for other jurisdictions' legislation. We recommend that an analysis be made on the impact on overseas certificated holder sand include some further points under recommendation 2.

We believe that listed company articles should already allow for shares to be issued in both certificated and uncertificated forms. As previously noted, as long as there is a mechanism to issue shares to all holders in a digital format then there might not be a requirement to change articles. Companies should still seek to remove certificated wording and change those aspects of their articles dealing with branch registers and forfeiture. This would need to be supported by analysis on the impact to overseas certificated holders and on branch registers.

The digitised model would need to be in place before the halting of share certificate issuance. Crucially, issuers and shareholders should know how to send and receive digital shares for new issuances such as drips, scrips and, share plan exercises and issues.

Recommendation 2 - the government should bring forward legislation to require dematerialisation of all share certificates at a future date, to be determined as soon as possible, in conjunction with Recommendation 1.

We agree with this recommendation but question whether it should run in conjunction with recommendation 1. We suggest that they be sequenced. As alluded to above, there will be issues with overseas certificated shareholders who have limited or no access to brokers or nominees for UK securities. Some of these shareholders might even be employees so it will be critical that a solution is found.

Overseas branch registers are currently held outside of CREST and as a consequence will need to be moved into the CSD environment under the recommended model. We therefore recommend an analysis of the impact of dematerialisation on overseas branch registers. It is very likely that changes would need to be made to regulations and systems to create more flexibility and allow branch registers to be held within a CSD and be in both certificated and uncertificated form depending on the local rules/regulations of the branch register.

Recommendation 3 – the government should consult with issuer and investor representatives on the preferred disposition of 'residual' paper share interests and whether a time limit should be imposed for the identification of untraced UBOs.

We agree with this recommendation with the caveat that further efforts should be made to define 'residual' and "untraced".

This emphasises our recommendation that retail certificated holders be consulted separately as they will be the most affected. As noted above, any such consultation process should be clear on the rights that retail investors would have under a new system, to avoid any potential misunderstanding regarding their access to and ability to exercise their rights. We want the UK to be the most competitive market in the world and direct retail investment is a crucial aspect of this. The diverse makeup of retail shareholders must be considered, in particular those with protected characteristics such as age or disability. Any consultation process should ascertain how this community can be supported through the process and whether timelines are manageable.

Recommendation 4 - Intermediaries should have an obligation, as a condition of participation in the clearing and settlement system, to put in place common technology that enables them to respond to UBO requests from issuers within a very short timeframe.

As noted in question 8, we believe that there should be a system which allows for data to be automatically collected and reports uploaded in real-time, with issuers having access as well. There should be restrictions on how the information is used and if the information can be shared beyond the issuer level.

Recommendation 5 – Intermediaries offering shareholder services should be fully transparent about whether and the extent to which clients can access their rights as shareholders, as well as any charges imposed for that service.

We note that there are many services that registered holders currently get for free but might have to pay for in the future – e.g. holding shares, attending and participating at general meetings, receiving shareholder communications and receiving dividends. There needs to be a transparent impact study in relation to how UBOs will be charged to exercise their rights. This is particularly the case for international shareholders for whom there will be a reduced choice of nominee providers.

We therefore emphasise the importance that a minimum nominee service for UBOs be agreed by the Digitisation Taskforce. We recommend that this minimum service includes holding the shares, receiving dividends, receipt of all shareholder communications and the ability to attend and participate at company general meetings. UBOs should be permitted to

opt out of these services and pay a lower fee but we believe that all these services should be on offer by nominees.

We also think that the additional issue on which the Digitisation Taskforce should consult with retail investors is the rights that the nominee will have to deal with the legal title to the shares (or more specifically the limitations to those rights) and the rights the UBOs are able to exercise over their beneficial title to the shares.

Recommendation 6 – Where intermediaries offer access to shareholder rights, the baseline service should facilitate the ability to vote, with confirmation that the vote has been recorded, and provide an efficient and reliable two-way communication and messaging channel, through intermediaries, between the issuer and the UBOs, as described above.

As noted above, we recommend that the baseline service includes holding the shares, receiving dividends, receipt of all shareholder communications and the ability to attend and participate at company general meetings.

We recommend that further work be undertaken on what the two-way messaging and communication channel will be designed to achieve over and above what is already in place. We agree that UBOs should receive the same information as a certificated shareholder already receives. We note that issuers already provide all shareholders and potential investors with contact information, and issuers do not respond differently to those investors who hold through nominees to those who are certificated shareholders.

Notwithstanding the above, we believe that there should be further consultation with the retail investor community to consider if there are ways to improve communications between issuers and shareholders.

Recommendation 7 – Following digitisation of certificated shareholdings the industry should move, with legislative support, to withdraw cheque payments and mandate direct payment to the UBO's nominated bank account.

We agree with this recommendation. We would like to flag that various issuers have already begun withdrawing cheque payments as an option to certificated holders. Given the recommended model, issuers would begin sending dividend payments to CREST accounts of nominees as already occurs. This model removes certificated holding as an option so there would not be any need for cheque payments by issuers.

We doubt therefore that there will be a need for legislative support but are happy to support the Taskforce if they deem it necessary.