Runway East
2 Whitechapel Road
London
E1 1EW

By email to: digitisationtaskforce@hmtreasury.gov.uk

Sir Douglas Flint
Chair
Digitisation Task Force
HM Treasury

24 September 2023

Dear Sir Douglas,

Response to the Digitisation Taskforce - Interim Report July 2023

I am pleased to respond to the Digitisation Taskforce Interim Report July 2023 on behalf of ShareAction, a registered charity established to promote transparency and responsible investment practices throughout the financial services sector. We are a member organisation and count amongst our members well-known NGOs and charitable foundations and over 26,000 individual supporters.

Among other activities, we work with the financial services sector to promote integration of sustainability factors in investment decisions, long-term stewardship of assets and the consideration of the views of clients, beneficiaries and pension scheme members. We have several investor coalitions taking collective action on issues such as climate change, biodiversity, workforce conditions and public health. We also support retail investors and AGM activists in attending AGMs, asking questions of company boards, voting and filing shareholder resolutions. Shareholder rights are therefore essential to our work.

ShareAction welcomes the government taking a fresh look at ways in which the UK's shareholding framework could and should be enhanced. We see significant benefits in many aspects of digitisation provided that this extends and supports shareholder rights.

We were pleased that the previous report in this area, the UK Secondary Capital Raising Review dated July 2022, acknowledged concerns highlighted by the Law Commission that retail investors are unable to exercise their voting rights effectively. The July 2022 report stated that all beneficial holders of shares, whether institutional or retail, should be able to exercise their shareholder rights effectively and efficiently.

We are concerned that recommendations of the Digitisation Taskforce - Interim Report July 2023 ("the Report") may in fact negatively impact the position of retail investors for the following reasons:

1. The proposals risk seriously undermining the shareholder rights of retail investors:
    - We were pleased that the Terms of Reference of the Digitisation Taskforce had stated regarding the rights of intermediated investors and existing certificated shareholders respectively that:
        - *"Ultimate investors who hold shares with intermediaries should be able to effectively and efficiently exercise the rights associated with direct share ownership including voting, receiving information and other corporate actions. The ability to exercise such rights as a default should be universal, irrespective of the intermediary that an investor uses."*
        - *"The removal of paper certificates should not result in the degradation of the rights of current holders of paper certificates to, for example, vote, receive information and participate in corporate actions."*
    - However we are concerned about the proposals described in the Report. The Report stated at points 5 and 6 of its executive summary that "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" and "where intermediaries offer access to shareholder rights, the baseline service should facilitate the ability to vote" (our emphasis added). This wording implies that the inclusion of shareholder rights in the service offering of intermediaries would be optional rather than standard and that the exercise of shareholder rights may even involve the imposition of additional costs to shareholders. This promotes the continuation of existing poor practice amongst nominee service providers. Our supporters have routinely experienced barriers to fully participating in corporate actions and in AGMs as beneficial owners, with unacceptable delays in correspondence, considerable cost, or an absence of relevant shareholder services being common problems.
    - The Report acknowledges the importance of retail investors having the ability to vote. However the Report does not mention any measures to ensure the protection of other essential shareholder rights which certificated shareholders currently freely enjoy such as the ability to attend AGMs, to ask questions of the Board, to vote, to appoint a proxy, to file shareholder resolutions and to requisition general meetings.
    - The report therefore fails to deliver on the Taskforce's Terms of Reference to either improve the ability of intermediated investors to exercise their rights or to protect the rights of existing certificated shareholders.

2. The proposals would lead to increased costs for certificated retail investors:
    - The issuer currently bears the costs of the paper certificated system. The holders of certificated shares do not pay an annual fee for owning their shares.
    - The proposal to move all certificated shares to a nominee or to the CSD would result in increased costs for retail investors following dematerialisation as they, in most instances, would be required to pay ongoing management fees and, potentially, additional fees to exercise shareholder rights such as attending AGMs.
    - We consider it unreasonable to expect certificated shareholders to pay increased costs to access their shareholder rights, especially when the current proposals seem to be driven by a wish to reduce costs for issuers.

3. The Taskforce risks rejecting the model that would be the most acceptable to certificated shareholders:
    - We favour Model 1 of the models proposed. This would appear to us to be the most sensible proposal as it provides the best prospect for the retention of shareholder rights whilst remaining comparatively low cost.
    - Model 2 does not appear to be viable and Model 4 does not appear to be viable within a reasonable timescale.
    - Model 3 risks being adopted as the recommended approach. We fear that this is the model that is being encouraged by Euroclear and by intermediaries who stand to benefit. In our view it is ordinary individual shareholders who would suffer through the degradation of their shareholder rights and the increase in the costs of owning shares. This does not appear to us to be a reasonable outcome of this process and is contrary to the recommendations of the July 2022 report.

4. Dematerialisation could result in breaches of human rights:
    - We are very concerned about any potential mandatory transfer of the legal title of certificated shares to a nominee, under the currently recommended Model 3, should this lead to breaches of the ECHR/Human Rights Act 1998 and harm to retail shareholders in the UK.
    - Model 1 appears to be a more serviceable option that avoids this significant risk as current certificated shareholders, once digitised under this system, would remain as members of the company.

5. The proposals risk increasing the market power of the major players:
    - We are generally in favour of free markets and competition, especially when this leads to market efficiencies, competitive pricing and better products and services for consumers.
    - However we are concerned that the proposals in the Report are likely to lead to increased market power for the major players.
    - We note that Euroclear already holds a monopoly position as CSD. We are concerned about the proposed additional monopolistic role for Euroclear as central nominee.
    - We are also concerned that in the absence of the ability of individual shareholders to hold shares directly, commercial nominees could use their market power to increase the fees charged for shareholder services or cease to offer shareholder services that match the rights that existing certificated shareholders currently enjoy.

6. The recommendations risk damaging shareholder engagement and investor stewardship:
    - The rights of shareholders are key to the robust engagement between shareholders, stakeholders and the company which is necessary for effective corporate accountability. Individual shareholders, in our experience, help to ensure that the voices of communities affected by corporate activity are represented and heard by the company and that shareholders have the ability to respond to environmental and social challenges.
    - To fulfil this well-established function, individual shareholders need the right to be able to attend an AGM, assign proxy representatives, vote, ask questions of the Board, receive information, directly communicate with the company and participate in corporate actions such as shareholder resolutions to hold the company to account.
    - Individual shareholders, and our supporters, value the fact that they can exercise all of these rights freely and easily by holding shares directly in a company.

- In our experience, individual shareholders who hold shares via a nominee face many practical barriers to exercising the same rights, including the failure of brokers to provide valid proof of ownership to facilitate support of a shareholder resolution or communication with a company; unacceptable delays in correspondence leading to failure to carry out requests; or the lack of service offering for many of these rights.

In relation to the specific questions in the Report we have provided some brief comments below.

We further request a follow-up meeting with Sir Douglas Flint and the Treasury team overseeing the process to highlight our concerns and discuss how the proposals can be improved, in particular to prevent the degradation of the rights of existing certificated shareholders.

Please do not hesitate to contact us if you require any clarification on specific points.

ShareAction's response to the questions in the Digitisation Taskforce - Interim Report July 2023

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?

We are not submitting a view on this question at this stage. We await further details of the process to be recommended and we would like to comment on the proposed implementation plan.

Our main concern is to ensure that shareholder rights are protected and are not undermined at any stage of dematerialisation.

The move to dematerialisation will lead to scams prompted by this change and the consequent risk of retail investors being defrauded. The implementation plan should include proposals aiming to minimise such risks.

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?

Three possibilities are outlined on page 13 of the Report. We consider that the third option, an authorised reclaim fund under the UK's Dormant Assets Scheme, would be most appropriate.

We recommend that UBOs should have a lengthy longstop date to come forward with a valid claim and we would consider 20 years to be reasonable.

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?

No, we do not support each issuer having this option. We consider that all such residual certificated shareholdings should be managed in one place and that this should be the UK's Dormant Assets

Scheme. The UK Dormant Assets Scheme is a well-established scheme that is well-placed to perform this role. It would also be far less burdensome for individual shareholders to contact one entity than pursue one or more issuers, some of whom may not be easily identifiable.

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

We acknowledge that the need to accommodate manual, paper-based processes for the residual certificated shareholder base leads to inefficiencies and increased costs for issuers. Digitisation will have various benefits for issuers including efficiencies and cost savings.

It would be unreasonable if retail investors were negatively impacted as a result of a change that benefits issuers. This process must not be imposed on retail investors in a way that impinges on their fundamental shareholder rights or leads to higher costs.

Our priority in this response is to protect the shareholder rights of retail investors. We submit that the most important issue for certificated shareholders is that they continue to be able to exercise freely all of the rights that they currently have as shareholders. We recently conducted a survey of our supporters who have confirmed the importance of this. We consider that the question of whether shareholdings should be held on a register inside or outside the CSD only matters to the extent that it impacts on their ability to exercise their shareholder rights, including the ability to engage directly with the company.

As stated above, of the four digitised share models proposed in the Report we think that Model 1 would be the best, or least harmful, option.

Model 1 appears to us to be the most sensible proposal for the following reasons:

1. It would replicate the current system but in digitised form. Retail investors should therefore be more comfortable with that change, particularly if system is managed by the registrar who previously managed the paper-based system.

2. This would seem to be the least onerous option for retail investors, in particular by not requiring additional KYC procedures.

3. It appears likely that this would be the lowest cost option. This would be an issue for retail investors if issuers attempt to pass on any costs of digitisation.

4. Most importantly, we believe that Model 1 provides the best prospect for the retention of the fundamental shareholder rights of retail investors. We explain below why Model 3 risks an erosion of these rights.

Model 3 risks being adopted as the recommended approach. We fear that this is the model that is being encouraged by Euroclear and by intermediaries who stand to benefit. In our view it is retail investors who would suffer through the degradation of their shareholder rights and the increase in the costs of owning shares. This does not appear to us to be a reasonable outcome of this process and is contrary to the recommendations of the July 2022 report.

We submit that there are a number of significant problems with Model 3 from the perspective of retail investors. In particular:

1. The fundamental shareholder rights of retail investors would be negatively impacted in Model 3. We refer you again to the statement on page 2 that "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." Shareholder rights should not be considered optional, they should not be dependent on the service offering of the intermediary, and retail shareholders should not be required to pay additional charges to exercise their rights.

2. In addition to the above procedure being deficient, the substantive content of the shareholder rights is also deficient. Page 2 only refers to the ability to vote. Shareholder rights include other important powers such as the ability to attend AGMs, to ask questions of the Board, to vote, to appoint a proxy, to file shareholder resolutions and to requisition general meetings. The protection of these rights is not addressed anywhere in the Report; indeed the Report does not consider it necessary to mandate an obligation on every intermediary to offer access to UBOs for expression of their rights, which raises the likelihood that these shareholder rights would be eroded over time.

3. The adoption of Model 3 would be more onerous for previously certificated shareholders who would need to sign paperwork and go through various checks including KYC/AML procedures before being taken on by a nominee.

4. Model 3 is likely to lead to increased costs for retail investors as they would, in most instances, be required to pay ongoing fees to the nominee, for example annual management fees or charges for shareholder services, such as Letters of Representation for attending AGMs or assigning proxy representatives.

5. The change to a nominee is likely to cause confusion and concern, particularly for older investors who prefer paper copies to electronic communications. (Such investors are more likely to be reassured by Model 1 as communications would remain with the same entity, the registrar.)

6. This process is certain to encourage scams in this area which would defraud some, and potentially many, retail investors. The problem of scams and fraud as a result of dematerialisation is not mentioned in the Report but must be considered and measures must be put in place to minimise the risk to retail consumers.

We would also like to challenge the statement made in relation to Model 3 that "We have not found any evidence that certificated shareholders, once dematerialised, would have a preference as to whether their interests are held through the CSD or recorded in a subregister outside the CSD – their original preference was simply to receive a paper certificate". We would like to know what work has been undertaken by the Digitisation Taskforce to understand the preferences of thousands of individual certificated shareholders. As stated above, we suggest that what is actually important to certificated shareholders is that they have proof of ownership of their shares together with the ability to exercise their shareholder rights should they wish to do so, and not to be forced into intermediation via a nominee.

We note comments in the Report that **Model 2** does not appear to be viable and **Model 4** does not appear to be viable within a reasonable timescale.

We consider that digitisation is unlikely to be achievable within a short timescale and that all the models proposed (and indeed any new models that become feasible due to technological innovation) should be re-evaluated in due course.

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?

No, we do not agree that this is the optimal architecture. In particular we disagree that this should be administered through nominees for the reasons stated in response to question 4.

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?

No, we do not agree that current certificated shareholders should be required to move their shares to a nominee, whether this is a nominee of their own choice or not, for the reasons stated in response to question 4.

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?

No, we do not agree that the facilitation of shareholder rights should be left to market forces.

Shareholder rights are a long-standing, crucial part of corporate governance and stewardship. As one of our supporters, Richard, told us in response to our recent survey: "The interim report minimum standards for shareholder participation are too low. Simply being able to vote is not enough. Full participation as a shareholder should be available as a minimum, and competition can be on cost or ease of access rather than on whether or not to provide access to shareholder rights. Protecting shareholder rights will offer a long term robust approach to shareholder involvement and can allow active shareholder participation to increase, strengthening corporate governance when more accountability is needed."

As noted above the Law Commission has already highlighted the difficulties that retail investors face in trying exercise their rights when they hold shares via online platforms. This problem is referenced in the July 2022 report which states at paragraphs 10.66 to 10.68:

10.66 This issue has been highlighted by the Law Commission and is frequently raised in the context of the inability of retail investors to exercise voting rights either effectively or at all where they hold via online platforms. Respondents have highlighted that certain retail platforms have developed functionality to enable this, however this is not applied consistently across the industry.

10.67 The principal reasons put forward as to why platforms fail to do this consistently is that they have limited incentive to incur the associated administrative costs involved. Such retail platforms also cite that where they do make such functionality available, retail engagement is low, making it not worthwhile. There is a cogent argument that this logic is circular and creates a self-fulfilling prophecy, where firms do not invest in easy to use services or place high charges on them and do not actively market them, leading to such services being unattractive to or not known about by retail investors, which is then used as a justification for lack of investment by intermediaries. This cycle needs to be broken.

10.68 The consequence of the above issues introduced by intermediation is that retail investors who hold certificated shares are arguably better able to exercise their shareholder rights than retail investors who have an interest in dematerialised shares held through an intermediary chain via CREST.

We agree with the comment on page 20 of the Report that "There should be no distinction in access to rights between shareholders who are directly registered and those who hold their shares through intermediaries" but in reality there clearly is a significant difference.

Retail platforms and other intermediaries do not currently give online retail investors the ability to exercise their rights efficiently and effectively. We would be delighted if retail platforms and other intermediaries started offering the same rights that certificated shareholders currently enjoy but we have no expectation that this will happen.

We are not confident that the proposals in the Digitisation Taskforce - Interim Report July 2023 would resolve these concerns; in fact we are certain that the adoption of Model 3 would lead to a further erosion of the shareholder rights of retail investors, particularly shareholders who are currently certificated.

There are several aspects of the wording of the section in the Report entitled "Facilitating access to shareholder rights" that raise concerns. In particular:

- Shareholder rights are seen as optional. The Report comments "we do not believe that it is necessary to mandate an obligation on every intermediary to offer access to UBOs for expression of their rights as long as they are transparent that this is their service proposition".
- Shareholder rights are defined narrowly. The "baseline service level" described on page 20 is mainly limited to voting and communications. As previously stated there is no mention of the ability to attend AGMs, to ask questions of the Board, to vote, to appoint a proxy, to file shareholder resolutions and to requisition general meetings.

We acknowledge that investor engagement through retail platforms can be low. This may be for many reasons including investors not knowing about such services or platforms not providing them. However this means that it is all the more important for there to be alternative routes through which investors can fully exercise their shareholder rights. Currently the purchasing of certificated shares through a registrar is one of these routes.

<u>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'</u>

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?

It is impossible to respond properly to this question without clarification about its meaning. However we would like to state that in principle every UBO should be communicated with, regardless of the size of their holding, and all UBOs should receive the same information pertaining to their role as shareholders, for example notification of AGMs.

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?

No, we do not agree that only issuers should have the ability to access information below the level of what is recorded on the company's share register. Shareholders must be able to hold directors to account and must be able to have access to the contact information of other shareholders, so as to allow shareholders to requisition shareholder resolutions, general meetings and require the company to distribute statements from dissenting shareholders to all the other shareholders.

Alternative solutions that protect the above "proper purpose" rights while enhancing the data protection of shareholder personal information have been suggested by other actors and could be developed, such as issuers/registrars determining whether communications requests meet the "proper purpose" test and then passing on the requests. Email addresses and consent to email communications would need to be added to share registers to facilitate this efficiently.

The Taskforce should therefore consider such solutions that ensure the retention of the key principle that shareholders should be able to communicate with other shareholders about important matters relating to the company.

Recommendations 5, 6 and 7

There is no question following Recommendations 5, 6 and 7. There are questions following Recommendations 1, 2, 3 and 4 so we respond here on the points raised in the section containing Recommendations 5, 6 and 7.

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.

As stated above we challenge this. This wording implies that the inclusion of shareholder rights in the service offering of intermediaries would be optional rather than standard and that the exercise of shareholder rights may even involve the imposition of additional costs to shareholders. Shareholder rights should not be optional, they should not be dependent on the service offering of the intermediary, and they should not require retail shareholders to pay additional charges for them.

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 stated above we challenge this. This recommendation only refers to the ability to vote. Shareholder rights include other important powers such as the ability to attend AGMs, to ask questions of the Board, to vote, to appoint a proxy, to file shareholder resolutions and to requisition general meetings. The protection of these rights is not addressed anywhere in the Report which raises the likelihood that these shareholder rights would be eroded over time.

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.

Cheques are no longer being phased out in the UK but it appears sensible to change all payments to direct payments to a nominated bank account. There will be risks in doing this, including fraud and human error, and procedures will need to be developed to minimise such risks for retail investors.

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Please do not hesitate to contact us if you require any clarification on any points raised in this letter.

As noted above we request a follow-up meeting with Sir Douglas Flint and the Treasury team overseeing the process to highlight our concerns and discuss how the proposals can be improved, in particular to prevent the degradation of the rights of existing certificated shareholders.

Many thanks,

Claire Brinn

Claire Brinn
UK Policy Manager

ShareAction
Runway East, 2 Whitechapel Road, London E1 1EW
T: +44 (0)20 7403 7800
W: shareaction.org