Quoted Companies Alliance

6 Kinghorn Street
London EC1A 7HW

T +44 (0)20 7600 3745
mail@theqca.com

www.theqca.com

Sir Douglas Flint
1 Horse Guards Road
London
SW1A 2HQ

digitisationtaskforce@hmtreasury.gov.uk

Monday 25 September 2023

Dear Sir Douglas,

Digitisation Taskforce Interim Report

We welcome the opportunity to provide feedback on the Interim Report of the Digitisation Taskforce.

The Quoted Companies Alliance has examined the proposals and advised on this response from the viewpoint of small and mid-sized quoted companies.

Overall, we welcome the Government's desire to modernise the UK's system and deliver reforms to its shareholding framework and market practice. It is essential that an effective and efficient system is established that emboldens the UK's position as a global financial centre. To achieve this, it is imperative that both the practical and financial implications of the potential options for reform are understood, and any potential costs or negative impacts are mitigated and addressed.

Regarding the interim report, we agree with the principle to discontinue the issuance of new share certificates. However, our members have concerns in relation to the proposed solution of moving all certificated shares to the UK's central securities depository (CSD), CREST, to be intermediated and administered through a nominee. Chief amongst these concerns is the cost that small and mid-sized quoted companies will likely incur as a result of this transition.

In reviewing the interim report's recommendations, our members have expressed strong views that the preferred approach (option 3 – to mandate all certificated shares to be moved to the CSD and intermediated and administered through a nominee) is not appropriate. In particular, members have raised concerns around the cost and complexities that issuers would face, along with issues for shareholders who would lose direct ownership of their shares as well as the rights that go along with that.

We would also urge the Taskforce to give greater consideration to the models operated within other jurisdictions. In particular, the Australia model, where the registrar maintains the register and can provide holding certificates without the need for a nominee to be interposed, as well as the use of the HIN (Holder Identification Number). The latter allows for much greater transparency for beneficial holdings, more effective ability to transfer between nominees, as well as benefits for HMRC.

If you would like to discuss our response in more detail, please do not hesitate to contact us.

Yours sincerely,

James Ashton
Chief Executive

Q1 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?

Firstly, with regard to recommendation 1 (which suggests elimination of fresh issuances of certificates in the near term), we foresee that this will create a number of challenges in shareholders' ability to participate in corporate activities, such as rights issues and dividend reinvestment plans. Moreover, all stakeholders would additionally need to accommodate dual processing arrangements in the interim period until the future dematerialisation model is introduced. It is important that any cessation of issuance of certificates should be coordinated with the move to an agreed full dematerialisation model.

With regard to recommendation 2, if the option of mandatory intermediation (option 3) is taken forward, we believe that, at a minimum, a period of at least two years should be given following the implementation of the required legislation before requiring all share certificates to be dematerialised. The scale of the transition is considerable and would require significant resource and logistical effort that would take much longer than the report suggests.

If, however, the digital register model (option 1) is the option that is taken forward, we consider that this approach could be implemented at a quicker pace, and perhaps within one year following the implementation of the required legislation.

Q2 What approach should be taken to the disposition of 'residual paper shares, and should a time limit be imposed for identifying untraced UBOs?

We do not consider that the options provided within the interim report will be without their challenges, in particular in relation to the complexities faced by market participants, as well as the potential for shareholder dissatisfaction. We have outlined below where our members key concerns lie.

The option in relation to the transfer of assets into a Corporate Sponsored Nominee (CSN) until subsequently forfeited will create problems for issuers. Most notably, this will create additional burdens for issuers in continuing to hold the shares of investors in their records, as well as result in further costs in setting up a CSN which is classified as a regulatory activity. Moreover, there are considerable challenges in relation to the ability to source and engage with certain shareholders, and in particular those in a different country of residence. In this situation, and where no shareholder consent is provided, these individuals cannot be defaulted into a nominee arrangement, and further legislative changes would be required for this to occur.

Regarding the option around the expanded Dormant Asset Scheme, it is not currently clear as to how this would work in practice given that the scheme does not currently operate within the securities sectors.

Finally, the forced sale of assets could prove to be controversial and result in investor dissatisfaction if a claimant eventually comes forward.

We believe that whatever model is taken forward, it is imperative that the costs on issuers in tracing certificated shareholders should be minimal.

Q3 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 – we believe that issuers should continue to have discretion with regards to uncontactable shareholders.

Q4 Is the ability to have digitised shareholdings held on a register outside the CSD important to issuers or UBOs?

Yes – on the whole, our members consider that the ability to have digitised shareholdings held on a register outside the CSD is important for both issuers and UBOs. We also note that this has been done in other jurisdictions where the system works in digitised form. Our members consider maintaining a register outside the CSD will be beneficial:

- To avoid any forced transfer of legal ownership over the shares, and facilitate ongoing retention of important shareholder rights.
- For issuers that do not want to or may find it difficult to bear the additional costs involved in the establishment of a CSN.
- For shareholders who are digitally disadvantaged or are non-UK residents.
- For Non-UK listings.
- For certain nominees and their eligibility.
- When dealing with securities which would not be eligible for CSD enablement, or unlisted securities that are not accepted by some retail brokers.

Q5 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 – on balance, our members do not consider that the taskforce's recommendation that the optimal architecture for all digitised shareholdings to be recorded in the CSD and managed and administered through nominees is appropriate. In particular, our members have strong concerns with the recommended approach and its impact on small and mid-sized quoted companies, such as those on AIM and AQSE.

If the recommended approach is to be taken forward, this is likely to result in issuers incurring considerable additional costs. Whilst there may be some cost savings as a result of reduced member volumes on registers, there will be heightened costs that issuers have to bear. This is because formerly certificated shareholders are unlikely to want to pay charges when holding shares when it was previously free. Therefore, the cost of establishing and maintaining a CSN will fall on the issuer.

Whilst cost is our key concern, our members highlighted the following additional areas of concern with regards to the recommended approach:

- It would remove investor choice and impose new costs and legal requirements on shareholders, remove legal title and impede their access to shareholder rights.
- An additional layer will be added to the share issuance process as all new shareholders will have to undergo broker onboarding procedures, including verification of identity.
- The model would require all registrars to establish FCA-regulated CSNs, which can take up to a year to gain approval. This would also mean a delay to the implementation of the new system.
- Broker platform costs will likely rise over time if investors do not have any alternative holding method, which would be detrimental to UK investment.

- Some shareholders may not be able to appoint a nominee due to cost, limitations based on residency, or because their holding is too small for a broker to want to offer services.
- Investors will be transitioned into a regulated environment, which will impose compliance requirements between the nominee and investor, adding to intermediary costs.
- On an issue of new shares, all allottees will need to provide credit details at the time of allotment.
- Certain securities, such as non-transferable securities or warrants will not be eligible for CREST and thus will not be able to be maintained in the CSD.
- When credit details are unable to be provided or validated, this will result in an incomplete share register held in the CSD.
- It is unclear what will happen when a security ceases to be eligible for CREST, or if a shareholder is unable to find a broker who will accept them as a client.

Moreover, we would stress that it is currently unclear as to whether the broker/CSN market has the capacity to absorb the large numbers of formerly certificated shareholders and provide them with an efficient service. In addition to this, the transition of all currently certificated holdings to nominee accounts would impose significant up-front and ongoing costs and complexity for both shareholders and issuers.

Q6 D**o 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 – for the reasons outlined in our response to Question 5, our members strongly disagree with this approach, whether implemented in one or two stages. The primary reason for this is that the cost and complexity of the transition would be significant for issuers. The costs of participation on public markets are already substantial and the UK should not be looking to add further cost barriers.

Furthermore, it would impede shareholder access to their ownership rights.

Q7 D**o 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?**

Yes – our members agree that the facilitation of shareholder rights should be left to market forces.

Furthermore, some of our members stressed that the recommendations should go further and require all intermediaries to make baseline services available to UBOs, with price transparency. As part of this, there should be a requirement to outline baseline services, which would allow investors to choose to access their shareholder rights.

Q8 W**hat 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?**

At present, there is no contractual arrangement between issuers and the intermediation chain. The introduction of any such relationship would likely result in increased costs, as well as create timing issues in

relation to increasing the lead time for the introduction of the proposals and slowing down transactions when new intermediaries are introduced to the chain.

In terms of turnaround time, the request to disclose UBO identity made by an issuer should be transmitted by intermediaries to the next intermediary in the chain immediately and by no later than the close of business the same day. If the request is received after 16.00 during its business day, the intermediary should transmit the information without delay and by no later than 10.00 the next business day. Timescales for intermediary responses should carry similar obligations.

Regarding the 'baseline' legal obligations, these should be aligned with Section 793 requirements.

Q9 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?

At present, issuers are currently required to operate a Section 808 register which documents beneficial owners identified via a Section 793 disclosure request. Our members consider that this proposal would represent an unnecessary reversal and result in a decrease in transparency and therefore do not believe that this should change.