DIGITISING THE UK SECURITIES MARKET
THE CASE AGAINST AND A PROPOSAL TO ENFRANCHISE INDIRECT INVESTORS

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ABSTRACT

A Taskforce, appointed by HM Treasury, has recently proposed legislation to eliminate certificated (paper) shares and to require the investors currently holding paper shares to hold them indirectly through nominees. It has also suggested that disclosure combined with a common messaging protocol will enable the market to improve the ability of indirect shareholders to exercise their rights.

In this paper we make a case against legislation eliminating paper certificates. We argue that the industry does not need the Government to remove paper certificates. If they want paper certificates to disappear, they should develop a model for holding uncertificated shares directly that is affordable for retail investors. The Government should nevertheless intervene. It should encourage the Competition and Markets Authority to investigate the price structure of accounts for holding uncertificated shares directly with CREST, that operates as a monopoly provider for such accounts in the UK.

We further explain that the current system for holding shares indirectly disenfranchises investors and argue that this not only affects investors but also deprives issuers of oversight of their governance. We use empirical evidence to explain that disclosure combined with a common messaging protocol is unlikely to cause the market to develop a system that better enfranchises indirect shareholders. Consequently, we propose legislation to give indirect investors better access to shareholder rights.

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* The London School of Economics and Political Science (LSE) and Brunel University London respectively. This article relies on the empirical results acquired from eighteen interviewees. We sincerely thank each of them for having taken the time to share with us their experience and opinions on the different shareholding methods.

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I. INTRODUCTION

In July 2022, the UK Government set up the Digitisation Taskforce to eliminate paper certificates and to improve the current system of indirect share ownership.[1] In July 2023, the Digitisation Taskforce proposed to eliminate certificated shares, requiring existing holders of these shares to move them to indirect accounts. It also suggested that disclosure and a common messaging protocol will cause the market to make improvements to the position of indirect shareholders.[2]

The present article criticises this approach and adds to the debate in two ways. Firstly, it is the first academic contribution to examine the most recent initiative advanced in this area and to connect competition law with the topic of intermediated securities. Secondly, the article integrates empirical evidence into the academic legal analysis of the topic. To our knowledge this is the first academic article to do so.[3] The existing literature discusses the advantages and disadvantages of the current system but does not support the analysis with empirical evidence.[4] With funding from the British Academy, we conducted eighteen semi-structured interviews with legal practitioners, investors, custodians, registrars, technology experts and voting agents.

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[1] HM Treasury, Policy Paper Digitisation Taskforce – Terms of Reference, 20 July 2022 at https://www.gov.uk/government/publications/digitisation-taskforce/digitisation-taskforce-terms-of-reference (last accessed 6 January 2024).

[2] Digitisation Taskforce, *Interim Report*, 10 July 2023, 10 at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1168398/digitisation_report.pdf (last accessed 6 January 2024).

[3] The Government conducted an empirical study in 2016 (Department for Business, Innovation & Skill - "BIS", Paper No 261, Exploring the Intermediated Shareholding Model, January 2016, at https://www.gov.uk/government/publications/shareholding-the-role-of-intermediaries (last accessed 6 January 2024). Our own empirical work integrates the results of this study and of the consultations by the Law Commission for its Scoping Study on intermediated securities (Law Commission, *Intermediated securities: who owns your shares? A Scoping Paper*, November 2020 at https://cloud-platform-e218f50a4812967ba1215eaecede923f.s3.amazonaws.com/uploads/sites/30/2020/11/Law-Commission-Intermediated-Securities-Scoping-Paper-1.pdf (last accessed 12 January 2024) ("Law Commission, Scoping Paper").

[4] J. Benjamin, *Interest in Securities. A Property Law Analysis of the International Securities Markets* (Oxford 2000), L. Gullifer, "Ownership of Securities: the Problems Caused by Intermediation" in L. Gullifer and J. Payne, *Intermediated Securities. Legal Problems and Practical Issues* (Oxford 2010) 1-31 and J. Benjamin and L. Gullifer, "Stewardship and Collateral: The Advantages and Disadvantages of the No Look Through System" in L. Gullifer and J. Payne (eds) *Intermediated Securities and Beyond* (Oxford 2019) 215 – 235 and E. Micheler, "Custody chains and asset values: why crypto-securities are worth contemplating" (2015) 74 (3) CLJ 505, 510.

We selected our interviewees on the basis of their respective roles and expertise. Initial contact was made via email, and informed consent was obtained, ensuring confidentiality. We prepared a questionnaire, for which we received ethical approval by the grant's host institution, covering: (i) the ability of investors to vote and exercise other corporate rights, (ii) *omnibus* accounts and stock lending, (iii) shortfalls (losses due to insolvency, negligence, or fraud by intermediaries) and (iv) the role of technology. Interviews, conducted online, lasted 60 to 90 minutes and the questions were sent in advance. Some interviews required follow-up sessions for additional clarification and depth. Although limited in number, the interviewees are representative of standard market practices due to their respective professional backgrounds, and the dominance of a few large custodians with similar business models in the market. We have anonymised their contributions and refer to them by number (interviewee 1, interviewee 2 and so forth).[5] The interviews have enabled us to develop a deeper and empirically grounded understanding of the current model of holding securities.

In the following sections we firstly explain that shares in the UK are currently held in one of four forms. We will show that only certificated shareholders and those who hold uncertificated shares directly either as Participants in CREST or as sponsored CREST members have full access to the rights associated with their shares. Investors who hold shares through nominees and custodian do not have the same rights.

In section III we discuss the Digitisation Taskforce and its Interim Report. This is followed by section IV, where we use our empirical evidence to analyse the ability of the market to achieve reform justifying the elimination of paper certificates and improving the intermediated holding model.

[5] Interviewees identified by role and number: interviewee 1 (legal practitioner advising custodians), interviewee 2 (proxy voting advisor), interviewee 3 (legal practitioner advising regulators), interviewee 4 (custodian I), interviewee 5 (legal practitioner advising custodians), interviewee 6 (legal practitioner advising custodians), interviewee 7 (legal practitioner advising custodians), interviewee 8 (legal practitioner advising custodians), interviewee 9 (legal practitioner advising custodians), interviewee 10 (custodian II), interviewee 11 (legal practitioner advising custodians and institutional investors), interviewee 12 (institutional investor I), interviewee 13 (institutional investor II), interviewee 14 (registrar I), interviewee 15 (registrar II), interviewee 16 (retail investor), interviewee 17 (investor communications expert) and interviewee 18 (legal practitioner advising shareholder litigants).

In section V we examine the Government's previous and failed attempt to encourage the industry to carry out reform. Section VI shows that the Shareholder Rights Directive II,[6] which imposes mandatory requirements on the industry, triggered reform, but did not improve the ability of all investors to enforce claims. The Directive does not apply to retail investors.

Section VII argues that a lack of competition may explain the poor quality of the current infrastructure. We observe that operational availability of enforcement rights is important for the oversight of issuers and argue that it would be wrong to rely exclusively on large institutional investors to oversee them.

Section VIII discusses the solutions proposed by the Digitisation Taskforce, the 'Industry Group', and the Law Commission. It concludes that the "proof is in the pudding". The market does not need the Government to eliminate paper certificates. If it offers an attractive model for holding uncertificated shares directly, investors will give up their certificates. To facilitate this, we propose that the Competition and Markets Authority investigate the excessively high fees charged for sponsored CREST accounts. We further believe that legislative intervention is required to impose a duty on custodians to facilitate the exercise of shareholder rights by intermediated investors. We also support the Law Commission's proposal to enfranchise ultimate investors by amending the Companies Act 2006 ("CA 2006") and the Financial Services and Markets Act 2000 ("FSMA 2000").

II. FOUR FORMS OF HOLDING SHARES

A. Certificated shares

Certificated shares is the traditional method through which investors hold shares. Holders of certificated shares have their name entered on the register of members of the issuer and receive a paper certificate evidencing this entry. They are considered legal owners and, can hence exercise all the rights associated with their shares.[7] They receive dividends directly from the issuer, can vote, and enforce any claims they have against the issuer.

[6] Shareholder Rights Directive II 2017/828/EU amended the Shareholder Rights Directive 2007/36/EC ("SRD").

[7] CA 2006, ss 112-113; *J Sainsbury plc v O'Connor (Inspector of Taxes)* [1991] 1 WLR 963 at 977 (Nourse LJ).

Mark Austin estimated that issuers in the FTSE 100 and in the Premium Equity Commercial Companies segment of the Official List currently issue 3% or less of their share capital in certificated form.[8] For AIM companies there appear to be more certificated holders.[9] The Law Commission reports that registrars, who assist listed companies in maintaining their share register, indicate that there are in excess of 10 million investors who hold their shares in certificated form.[10] We understand that holders of certificated shares are typically retail investors.[11] As already mentioned, the Digitisation Taskforce has proposed legislation to eliminate this form of holding shares.

B. Uncertificated shares (CREST participants and sponsored members)

Uncertificated shares are administered through the central register for all uncertificated shares in the UK, CREST,[12] which is operated by Euroclear UK & International.[13] If an investor decides to hold shares directly in uncertificated form, they can either become a CREST participant or a personal CREST member.[14]

CREST participants have a secure connection through which they send messages instructing the system to transfer securities to someone else's account, for example. They connect to

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[8] UK Secondary Capital Raising Review ("SCRR") Final Report, 19 July 2022 at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1091566/SCRR_Report_July_2022_final_.pdf (last accessed 6 January 2024) para 10.27.

[9] ibid.

[10] Law Commission, Scoping Paper, note 3 above, para. 8.6.

[11] The Lemon Fool: Shares, Investment and Personal Finance Discussion Forums, *Where's Left for a CREST Account?* CSD Twist the Knife at https://dev.lemonfool.co.uk/viewtopic.php?p=222568 (last accessed 19 June 2024); M. Lee, T. J. Catalano and D. Rubin, "Paper Stock Certificates: Where Have They Gone?", https://www.investopedia.com/ask/answers/06/stockcertificate.asp a and L. Walters, *How to prepare for the scrapping of paper share certificate*s, Investors' Chronicle, January 2024 at https://www.investorschronicle.co.uk/ideas/2024/01/02/how-to-prepare-for-the-scrapping-of-paper-share-certificates/ (last accessed 27 July 2024). See also joint response from UKSA and ShareSoc, Digitisation Taskforce – Interim Report, September 2023 para. 27 at https://www.sharesoc.org/wp-content/uploads/2023/09/Flint-Report-Joint-response-from-UKSA-and-Sharesoc-2023-09-08.pdf (last accessed 27 July 2024).

[12] CREST stands for Certificateless Registry for Electronic Share Transfer.

[13] Euroclear Services – Settlement Euroclear UK & International at https://www.euroclear.com/services/en/provider-homepage/euroclear-uk-international.html (last accessed 27 July 2024).

[14] SCRR, note 8 above, para 10.23 and Euroclear Services, Private investor services - Euroclear UK & International, 2022 at https://www.euroclear.com/services/en/private-investor-services/private-investor-services-euroclear-uk-and-international.html (last accessed 6 January 2024).

their computer a hardware unit supplied by CREST, which contains unique software keys.[15] The unit authenticates the messages that are sent between a participant and the CREST system. Personal CREST members are investors who have a CREST account in their own name but operate that account through a CREST participant, who sponsors them.

In the same way as certificated shares, an investor who holds uncertificated shares directly with CREST is considered the legal owner of these shares and can exercise all rights associated with them against the issuer. When CREST was first set up, the Taskforce responsible for its design and implementation stressed that the sponsored membership was important for enfranchising smaller investors.[16]

C. Uncertificated shares held through an intermediated account

The fourth option is for an investor to hold shares in uncertificated form but indirectly through a nominee account administered by a custodian. This form of holding shares increased after the introduction of uncertificated shares and has become the most common form for holding shares not only in the UK but world-wide.[17]

In this model the names of individual investors are not recorded on the shareholder register. Instead, CREST records the names of nominees. The custodians who operate the intermediated account directly with CREST often hold accounts for a further level of custodians. Sometimes there are several levels of custodians operating between issuers and ultimate investors.[18]

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[15] Euroclear, CREST Reference Manual, October 2023, 40 at https://my.euroclear.com/dam/EUI/Public/Legal%20documentation/CREST%20Reference%20Manual/2023-10-02-CREST-Reference-Manual-Registrar-Service-Standards-Investment-Funds-Service-clean.pdf (last accessed 27 July 2024).

[16] SCRR, note 8 above, para 10.21.

[17] *The Kay Review of UK Equity Markets and Long-Term Decision Making: Final Report*, July 2012 at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/253454/bis-12-917-kay-review-of-equity-markets-final-report.pdf (last accessed 6 January 2024), para 3.6 ("Kay Review"); UNIDROIT, *Explanatory Note of the Preliminary Draft of the UNIDROIT Convention on substantive legal rules regarding securities held through securities accounts*, December 2004, para. 1.2.3; SCRR, note 8 above, para 10.26.

[18] J. Benjamin, *Financial Law* (Oxford 2007) para. 19.04; see also L. Gullifer, *Goode on Legal Problems of Credit and Security*, 5th ed. (London 2017) para. 6-08 and L. Gullifer and J. Payne, "Introduction" in L. Gullifer and J. Payne (eds) *Intermediated Securities and Beyond*, note 4 above, 5-11.

As we have pointed out, only registered shareholders have legal ownership and can exercise rights directly against the company.[19] Intermediated investors have a mere beneficial right in the interests held by their immediate custodians[20] and consequently face legal and operational barriers to the exercise and enforcement of their rights.

Legal barriers arise from CA 2006, s 112, which requires companies to accept as shareholders only those individuals whose names are entered on the register of members. Investors who hold shares through one or more intermediaries, consequently have no rights to vote, attend meetings or enforce their rights against an issuer.[21] In theory custodians should pass rights to ultimate investors,[22] but custody agreements can exempt them from relaying information and facilitating voting, or allow them to charge expensive fees for this service.[23] Intermediated accounts can also undermine the ability of investors to enforce rights against issuers. For example, in 2014 the High Court held that an intermediated investor did not have standing to enforce a remedy under CA 2006 s. 98 (re-registering a public company as private).[24] Due to its similar wording it is likely that courts will reach the same conclusion for CA 2006 s. 633 (variation of class rights).[25] Intermediated investors are not able to vote on schemes of arrangement (CA 2006, s 899).[26] Concerns have also been raised over the difficulties

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[19] See note 7 above.

[20] M. Yates and G. Montage, *The Law of Global Custody*, 4th edn (London 2013) 128; G. Morton, "Historical Introduction: The Growth of Intermediation and Development of Legal Analysis of Intermediated Securities" in Gullifer and Payne (eds) *Intermediated Securities and Beyond*, n 4 above, 27-28; J. Benjamin, note 4 above, paras. 19.08 - 19.11; L. Gullifer, *Goode on Legal Problems of Credit and Security*, note 18 above, para. 6.18 and Financial Markets Law Committee ('FMLC'), *Issue 3 Property Interests in Investment Securities – Analysis of the Need for and Nature of Legislation Relating to Property Interests in Indirectly Held Investment Securities With a Statement of Principles for an Investment Securities Statute*, July 2004, para. 6.1.

[21] Law Commission, Scoping Paper, note 3 above, paras. 3.11 – 3.16.

[22] M. Yates and G. Montage, *The Law of Global Custody*, 4th edn, Tottel Publishing 2013) 128.

[23] Law Commission, Scoping Paper, note 3 above, para. 5.73.

[24] *Eckerle v Wickeder Westfalenstahl GmbH* [2013] EWHC 68 (Ch), [2014] Ch 196 at [209] to [211]; for an analysis of this case see E. Micheler, 'Custody chains and asset values', note 4 above, 515 – 519 and Maisie Ooi, "Re-enfranchising the investor of intermediated securities" (2020) 16 (1) *Journal of Private International Law*, 69 – 111.

[25] See on this point the Law Commission, Scoping Paper, note 3 above., para. 573.

[26] *Re Sirius Minerals plc* [2020] EWHC 1447 (Ch) (13 March 2020) at [22]; for an analysis of this case see Law Commission, Scoping Paper, note 3 above, paras. 4.17 – 4.23. On the effect of CA 2006 s 899 on ultimate investors see also the Unilever's proposed plan of 2018 to relocate the headquarters of Unilever plc from London to Rotterdam. The plan received considerable media attention due to the disenfranchisement of individual investors from voting on this scheme of arrangement. See, for example, D. Thorpe, "Pimfa warns investors will be locked

experienced by ultimate investors to enforce CA 2006, ss 338 (power to require circulation of resolutions for AGMs),[27] 570 and 571 (disapplication of pre-emption rights),[28] and also the FSMA 2000 , s 90A.[29]

The operational problems caused by the current system are due to the complexity and opacity of the holding chain. There are numerous layers of intermediation (often spanning multiple jurisdictions). Neither ultimate investors nor issuers know the identity of all the intermediaries operating along the chain.[30] We will see below that this structure limits the investors' ability to benefit from the rights associated with their shares.[31]

D. Summary

The four forms through which investors can hold shares differ substantially. Shareholders of certificated shares and shareholders of uncertificated shares, who have their names entered directly on the CREST register (as participants or as sponsored members), benefit from the full set of rights associated with their shares. Shareholders who hold shares indirectly through custodians do not.[32] In the following subsection we will discuss the proposal of the Digitisation Taskforce.

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out of Unilever vote", *FT Adviser*, October 2018 at https://www.ftadviser.com/investments/2018/10/02/pimfa-warns-investors-will-be-locked-out-of-unilever-vote/ (last accessed 27 May 2024) and ShareSoc, "Unilever abandons its plans. Another Victory for Individual Shareholders" at https://www.sharesoc.org/sharesoc-news/unilever-abandons-its-plans/ (last accessed 27 May 2024). While the plan was later abandoned by Unilever, it is indeed another example of a "scheme of arrangement on which ultimate investors wished to have their voices heard but were prevented by the tests in section 899", Law Commission, Scoping Paper, note 3 above, para. 4.23.

[27] This provision grants members the power to require circulation of resolutions for AGMs. The Law Commission emphasised that 'CA 2006 s 153 provides a procedure by which ultimate investors can make such a request, [… but] stakeholders including the Share Centre have mentioned that this process does not facilitate the exercise of these rights by ultimate investors", Law Commission, Scoping Paper, note 3 above, para. 5.73

[28] Law Commission, Scoping Paper, note 3 above, para. 5.73.

[29] Under FSMA 2000, s 90 A indirect investors are entitled to compensation for losses suffered due to false or misleading statements made by companies (*SL Claimants v Tesco plc* [2019] EWHC 2858 (Ch), [2020] Bus LR 250). However, a legal practitioner advising shareholder litigants (interviewee 18) mentioned that indirect investors experience difficulties proving their status due to the complexity of the holding chain and the lack of incentives for intermediaries to assist them (often due to conflict of interest). See also *Various Claimants v G4S Plc* [2023] EWCH 2863 (Ch) where intermediated investors claiming under FSMA 2000, s 90 A and Schedule 10 A were denied access to the company's documents.

[30] E. Micheler, "Intermediated Securities from the Perspective of Investors: Problems, Quick Fixes and Long-term Solutions" in Gullifer and Payne (eds) *Intermediated Securities and Beyond*, note 4 above 239.

[31] See below section IV. C.

[32] See also SCRR, note 8 above, para. 10.68.

III. THE DIGITISATION TASKFORCE

We have already reported that HM Treasury has appointed a Digitisation Taskforce.[33] Its terms of reference state that the existence of certificated shares causes costly arrangements but neither quantify nor substantiate this point.[34] The Taskforce's Interim Report concludes that, for listed companies, paper certificates need to be removed 'as a matter of urgency'.[35] It recommends legislation abolishing these shares and requiring existing holders of certificated (paper) in listed companies to hold these through a nominee. We have seen above that this would substantially modify the legal position of existing holders of certificated shares, transforming them from direct legal owners into intermediated beneficial owners.

The proposal deviates from a model advanced by the industry at an earlier stage, which envisaged that certificates be replaced with 'unique reference numbers'.[36] These were going to be used, together with other security information, to authenticate transactions on behalf of shareholders.[37] The registrars, who in addition to CREST assist issuers with maintaining shareholder registers, would provide digital access to the register that they maintain. The earlier proposal would have enabled the current holders of certificated shares to retain legal ownership albeit through a digital account administered by registrars, which might, with time, have attracted fees.

With a view to improving the current intermediated system of shareholder ownership, the Taskforce recommends legislation requiring intermediaries (i) to be transparent about the services they offer and (i) to use a common messaging protocol that enables messages to be

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[33] Digitisation Taskforce, *Terms of Reference* note 1 above; Cabinet Office and The RT Hon Lord Frost CMG, Policy Paper *Brexit Opportunities: regulatory reforms*, September 2021, at https://www.gov.uk/government/publications/brexit-opportunities-regulatory-reforms (last accessed 6 January 2024).

[34] Digitisation Taskforce, *Terms of Reference* note 1 above; see also SCRR, note 8 above, para 10.10.

[35] Digitisation Taskforce, *Interim Report* note 2 above, 10.

[36] Proposed Structure of Dematerialised UK Share Registers, 2014 at http://www-uk.computershare.com/webcontent/Doc.aspx?docid=%7Bdce7977c-c416-46df-8839-092820cd2869%7D (last accessed 6 January 2024), as cited in the Law Commission, Scoping Paper, note 3 above, fn 95.

[37] ibid., at 4.

distributed between issuers, intermediaries and investors. Otherwise, the Taskforce believes that we should rely on the market to make improvements.[38]

IV. THE ABILITY OF THE MARKET TO MAKE IMPROVEMENTS

A. Introduction

In this section we examine the problems affecting the current market in more detail and assess its ability to make improvements. We base this assessment on our empirical study. In addition to our empirical results, the section also contains our own assessment and analysis, which will be clearly identified in the text.

It has already been mentioned that CREST operates in the market as the register for all uncertificated shares issued in the UK. We have also said that there are registrars, who assist companies in maintaining their respective shareholder registers. Registrars mirror the CREST register for uncertificated shares and manage the register for shares that are held in certificated form. In addition, there are custodians, who operate nominee accounts either with CREST directly or through other custodians.

We will see that the market for direct CREST accounts suffers from a lack of competition. The providers of intermediated accounts also appear to lack competitive spirit. This may prevent the market from providing retail investors with a service that gives them full access to the corporate rights associated with their shares. Institutional investors and high value private investors are in a better position. They can access direct forms of holding securities. Recent legislative reforms have improved the ability of institutional investors with an intermediated account to vote but have unfortunately not improved their access to enforcing rights in court.

B. CREST participants and sponsored members

CREST operates the only central register for uncertificated securities on the basis of a license by the Government, which was issued under the Uncertificated Securities Regulations 2001.[39] One interviewee pointed out that, in their view, this monopoly status increases the level of

[38] Digitisation Taskforce, *Interim Report* note 2 above.

[39] SI 2001/3755.

operational risks.[40] Fees for CREST participants are high. They pay an account charge of at least £650 per month for low volume users and £1250 per month for standard users. In addition, there are service charges for individual transactions such as, for example, settlement charges, own account transfer charges, non-settling own account transfer charges, asset maintenance charges, fee per line chargers, netting fees, Central Counterparty fees or settlement discipline chargers.[41]

The market for sponsored accounts suffers from a similar lack of competition. There are only a few operators offering CREST sponsored accounts to retail investors.[42] CREST membership is now rarely used by them. The number of individuals holding securities directly through CREST had decreased from approximately 50,000 members in 2003 to 4,200 members in 2020.[43] None of the major investment platforms offer a direct CREST account.[44] Two registrars and one retail investor told us that stockbrokers use intermediation as the default option in their standard terms, without informing investors about the available option to hold shares directly.[45]

In 2020, the Law Commission identified only four brokers that offered personal CREST accounts at annual fees ranging between approximately £400 and £500[46]. This was confirmed

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[40] Interview 4 also questions whether the central securities depository should be owned and operated by the Government (as it was in the past).

[41] Euroclear UK & International, Our tariff, April 2024 at https://my.euroclear.com/dam/EUI/Public/Tariff%20documentation/EUI%20tariff/EUI-Tariff-Brochure-October-2023.pdf (last accessed 27 July 2024); Annex – Example Fee Calculations of this document (36-41) illustrates how fees are calculated.

[42] Law Commission, Scoping Paper, note 3 above, para. 2.58 and Interviewee 7.

[43] Law Commission, Scoping Paper, note 3 above, para 2.58; see also BIS Paper, note 3 above, para. 15-16.

[44] Memo on file with authors; see also ShareSoc, Personal Crest Accounts. Personal Crest Membership, June 2015 at https://www.sharesoc.org/investor-academy/advanced-topics/personal-crest-accounts/ (last accessed 19 June 2024) and The Lemon Fool, Shares, Investment and Personal Finance Discussions Forums, note 11 above. CREST accounts do not appear to benefit from the tax benefits associated with self-invested personal pension plans (GOV.UK, Personal pensions at https://www.gov.uk/personal-pensions-your-rights, last accessed 27 July 2024) and individual savings accounts (Individual Savings Account Regulations 1998, SI 1998/1870).

[45] Interviewees 14, 15 and 16; The Chartered Governance Institute, *Response to the call for evidence on Intermediated Securities*, November 2019 ("CGI Paper 2019"), 1; BIS Paper note 3 above, 80 and 133 and UK Shareholders' Association ("UKSA"), *Position Paper on Dematerialisation*, 24 December 2022, para. 61 and paras. 67 - 68.2, at https://www.uksa.org.uk/sites/default/files/2022-12/UKSA-position-on-dematerialisation-published-2022-12-24.pdf (last accessed 6 January 2024).

[46] Law Commission, Scoping Paper, note 3 above, p. 29, footnote 65; Interviewee 16; see also UKSA, *Position Paper on Dematerialisation*, note 45 above, para. 60.

by one retail investor who told us that in 2019 he switched from a sponsored direct CREST account to a 'nominee account' when the annual account fee charged by the broker had increased from approximately £10 to £500.[47] Since then the Law Commission's report fees have increased further. We identified and contacted three brokers, who currently offer this service, and requested information about their respective tariffs. Fees now range between £2000 and £3000 per annum.[48] Two of the brokers also require a minimum portfolio size ranging between £ 500,000 and £ 1,000,000, respectively. [49]

The reluctance of stockbrokers and investment platforms to offer direct CREST membership is sometimes attributed to the administrative burden associated with these accounts.[50] We note that the CREST tariff charges participants £120 per year as a fee for maintaining a personal account.[51] This is high but also suggests that brokers are requesting a significant mark-up. We also learnt that intermediation provides firms with a greater control over the securities, optimising the speed at which transactions are processed and facilitating certain activities generally associated with custody, such as stock lending and high frequency trading.[52] Service providers argue, unsurprisingly, that the demand for this model is limited.[53]

The picture is different for institutional and large-scale private investors. Some institutional investors (e.g. mature sovereign wealth funds, central banks or certain government institutions) set up their own CREST accounts and grant providers a power of attorney to operate such accounts on a day-to-day basis.[54] They sometimes also set up a contingency plan which requires the appointment of another provider that will step in and take over as an

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[47] Interviewee 16.

[48] Memo on file with authors.

[49] Ibid; Euroclear expressly states that personal CREST membership is more suitable for 'larger clients', as it is 'more expensive' than the option of using nominee accounts, Euroclear UK & International, *Personal Membership*, https://www.euroclear.com/content/dam/euroclear/operational-public/EUI/MA1593_EUIntl_Personal_Membership.pdf (last accessed 6 January 2024).

[50] BIS Paper, note 3 above, 80.

[51] Euroclear UK & International, Our tariff, n 41 above, 9.

[52] Interviewees 2, 4 and 16; see also P. Davies, "Investment Chains and Corporate Governance", in Gullifer and Payne (eds) *Intermediated Securities and Beyond*, note 4 above, 190.

[53] BIS Paper, note 3 above, 80.

[54] Interviewee 4.

account operator in those circumstances where the first provider becomes insolvent. These plans 'pop up' from time to time and are intended to avoid any type of disruption including the risk of a break down in communications with CREST.[55]

It is possible that the lack of bargaining power of retail investors, together with the lack of competition in this market, could have led to a situation where retail investors have been priced out of holding uncertificated securities directly. There is also a risk that the lack of competition may not give Euroclear and/or its participants an incentive to develop a business model improving the *status quo*.

C. Intermediated accounts

1. Introduction

In the following subsections, we analyse the market for intermediated shareholdings. For this, we have collected empirical evidence. We will discuss pooling, securities lending, technology, the resulting levels of service standards, and the attitudes of custodians.

2. Pooling

In a custody chain, each custodian records how many securities they have undertaken to hold for each of their clients. They then ensure that they themselves hold a corresponding amount of such securities at the next level. Custodians prefer to hold securities at this next level on a pooled or *omnibus* basis, where they hold the shares for several of their clients in the same account.

Custodians charge lower fees for pooled accounts.[56] Pooling, however, has disadvantages. It creates a structure that is prone to errors in the handling of client voting instructions, makes it difficult (if not impossible) for issuers to link votes to specific investors, prevents investors from ensuring that their instructions have been voted correctly,[57] and may significantly limit the client's voting choices in those circumstances where intermediaries have terms whereby

[55] ibid.

[56] See also BIS Paper, note 3 above, 16.

[57] Personal Investment Management & Financial Advice Association ("PIMFA"), *Response to Law Commission Intermediated Securities – Call for evidence*, 2019, 4-5.

they vote the same way for all the shares in the pool.[58] Unfortunately, investors are usually not fully aware of these disadvantages.[59]

Our study shows that in practice *omnibus* accounts have become the default market standard.[60] Custodians sometimes offer segregated or designated accounts, but these are more likely to be available to institutional than to retail investors.[61] The BIS study found that most retail investors are not aware that securities can be held in designated accounts.[62]

Moreover, it appears that segregation in any step of the custody chain does not necessarily resolve the operational problems that arise with *omnibus* accounts. We were told that when clients opt in favour of a segregated account, corporate rights may be jeopardized when their immediate custodian agrees to hold the shares in an *omnibus* account with a sub-custodian placed further up the chain.[63] We have also been told that investors are not always fully aware of these implications of pooling.[64]

3. Securities lending

Securities lending generates income for investors, who are paid by the borrower for making their securities available to them. We have been told that pension funds, in particular, benefit from securities lending.[65] Custodians also make money by charging fees for their services in

[58] Investors whose securities are commingled in an *omnibus* account are also more exposed to potential losses in the event of insolvency of one of the intermediaries in the chain.

[59] ESMA, EMIR Review Report No 3, *Review on the segregation and portability requirements*, 2015, 6.

[60] Interviewees 2, 12, 13 and 16. See also e.g. RBC *Europe Limited, Investment and Custody Services*, para. 4.1.19 (a) (d) (e); BYY Mellon, *Frequently Asked Questions: Omnibus and Segregated Account Offering for European Union (EU) Markets*, July 2020 at https://www.bnymellon.com/content/dam/bnymellon/documents/pdf/emea/csdr-omnibus-and-segregated-account-offering-for-eu-markets-faqs.pdf.coredownload.pdf (last accessed 6 January 2024) and HSBC, *CSD Regulation Article 38*, January 2022 at https://www.gbm.hsbc.com/financial-regulation/csdr/account-segregation (last accessed 6 January 2024).

[61] P. Davies, note 52 above, 201- 202.

[62] BIS Paper, note 3 above, 72.

[63] Interviewees 1, 8 and 9.

[64] Interviewees 4 and 16; see also BIS Paper, note 3 above, 32 and Law Commission, *Intermediated securities: Call for Evidence*, August 2019, para. 136 and PIMFA, note 57 above, 2.

[65] Interviewees 2, 3, 5, 6, 7, 8, 9 and 10. Interviewee 2 mentioned that securities lending can be incompatible with engagement policies of institutional investors.

organising lending for investors, allowing them to charge lower fees.[66] Lending also constitutes a source of money-market funding and plays an important role in short selling, facilitating more accurate market pricing.[67]

Like pooling, lending has disadvantages for investors. They temporarily lose ownership of the shares and need to recall them to exercise voting rights. A recall request is passed on from one custodian to the next. Information can get lost, such that a custodian further down the chain does not receive details on 'which [shares] to recall and when.'[68] When lending is arranged by a custodian close to the record date for a shareholder meeting, lenders may send voting instructions before they have received confirmation of the completion of a lending transaction. It can then happen that borrowers also send voting instructions through their own respective custodians and that both sets of instructions reach the issuer simultaneously. This can result in over-voting.[69]

4. Technology

Unfortunately, the operational problems that complicate the exercise of corporate rights also occur when shares are held in segregated accounts and there is no lending activity. This is because several custodians need to work together, one after the other, to facilitate the exercise of rights by ultimate investors. This can entail (i) delays and errors in passing information through the chain, (ii) failure to inform the investors about corporate events, (iii) difficulties in receiving voting forms or links to online voting, and (iv) problems for investors in obtaining confirmation that their votes have been received and/or counted.[70] One interviewee explained that the reason for this is that the procedure and technology used along

[66] More generally lending benefits financial markets by making available liquidity (P. Paech, "Securities, intermediation and the blockchain - an inevitable choice between liquidity and legal certainty?" Unif. Law Rev. (2016) 21 (4) 612-639).

[67] We are grateful to one of our reviewers for this point.

[68] Minerva Analytics, "Minerva Nexus Background Briefing: Sustainable Securities Lending" June 2021, 6.

[69] Interviewees 2, 12 and 13.

[70] Law Commission, Scoping Paper, note 3 above, paras. 3.1 – 3.80.

the custody chain can differ from one provider to another. Some firms use automated voting systems while others use manual arrangements.[71]

We have mentioned above that the Taskforce proposes to address operational problems through a common messaging protocol. We note that this could provide all levels in the chain with greater awareness of what information is needed but does not improve the procedures and systems used by each of these intermediaries.

While it would, of course, be possible for all custodians to switch over to a shared database, an individual intermediary will only make such an investment if they have an incentive to do so. The fact that some intermediaries continue to operate manual models suggests that no such incentive is present. It is possible that they do not experience sufficient competitive pressure to improve their respective systems.

5. Low service standards

The operational problems prevailing in the custody chain are reflected in the legal documentation underpinning the industry. During our study we identified contracts according to which 'unless expressly agreed in writing', intermediaries are exempt from passing information and facilitating voting.[72] Furthermore, even in circumstances where the ability of an investor to exercise corporate rights is expressly recognised by the agreement, such rights may be subject not only to the payment of an additional fee but also to a series of other conditions. For example, contracts sometimes impose tight deadlines on submitting voting instructions to the intermediary,[73] or limit the investor's ability to attend shareholder meetings. Custody contracts also frequently exclude assistance with enforcing rights.[74]

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[71] Interviewee 16; UKSA, *Position Paper on Dematerialisation*, note 16 above, para. 62.4; but see R. Uddin, "Hargreaves Lansdown launches digital voting service" FT, 20 January 2023, at *https://www.ft.com/content/560466f0-ecf4-4c80-82f0-0705410d7fdd* (last accessed 6 January 2024).

[72] EAR, *Securities Dealing and Custody Service Agreement*, para. 4.4 at https://www.eabplc.com/downloads/SecuritiesDealingandCustodyArrangementServicesAgreement.pdf (last accessed 6 January 2024).

[73] RBC *Europe Limited, Investment and Custody Services*, para. 7.17; Law Commission, Scoping Paper, note 3 above, para. 3.24.

[74] E. Micheler, "Custody chains and asset values", note 4 above, 510.

6. Attitudes of custodians

In principle, the industry possesses the technical skills and means to overcome the operational problems currently troubling the intermediated infrastructure. The problem is not the lack of suitable digital technology. The problem is that intermediaries do not have sufficient incentives to develop a better business model.[75]

The Chartered Governance Institute Registrars Group ("Registrars' Group") told the Law Commission that votes are more likely to be 'communicated and actioned in a timely, accurate and effective manner […] when a direct financial consequence hangs on the process' (e.g. in the context of takeovers or restructuring).[76] They stress that facilitating more engagement by investors is not always a priority for custodians and that it is more 'a lack of will than process-failure which inhibits the exercise of voting rights'.[77]

D. Summary

It is possible that Euroclear UK & International and the few intermediaries offering CREST sponsored accounts do not experience a sufficiently competitive environment. The reason for this could be that retail investors do not have enough bargaining power to negotiate reasonable fees that would allow them to connect to CREST through a sponsor. We believe that the CMA should investigate this further.

Intermediated services are provided either through segregated or pooled accounts. The pooling of accounts and securities lending, while making custody cheaper, trigger operational problems, which severely undermine the ability of investors to exercise rights. Unfortunately, operational problems also arise with segregated accounts that do not permit lending. Custodians do not appear to have the incentives to improve the quality of their service.

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[75] Interviewees 14, 15, 11, 6 and 7; see also UKSA, *Position Paper on Dematerialisation*, note 45 above, paras. 79-84. The BIS Paper (note 3 above, 18) concluded that intermediaries lack incentives 'to improve the accuracy of voting or deliver vote confirmation'; the CGI Paper 2019 (note 16 above, 4) notes that intermediaries have no incentive to make clients more aware 'of their entitlement to exercise votes'.

[76] Law Commission, Scoping Paper, note 3 above, para. 3.70 and the CGI Paper 2019, note 16 above, 2-3.

[77] Ibid; see also City of London Law Society, Response of the Joint Working Party of the City of London Law Society Company Law, Financial Law and Regulatory Law Committees to the Law Commission's Consultation on Intermediated Securities, November 2019, 9.

V. THE PREVIOUS ATTEMPT BY THE GOVERNMENT TO ENCOURAGE A MARKET-LED SOLUTION

The inability of the market to make improvements is evidenced by a previous attempt to bring about a market-led solution. In 2001, the Company Law Steering Group observed that the existing arrangements for indirectly held securities were 'obscure and unnecessarily complex'.[78] They also mentioned that they had 'great concern that solutions should be found'[79] and that they hoped that the market will produce these. They accepted assurances from market participants that 'in regard to the right to vote, advances in the use of electronic technology would very soon make it feasible, at low cost, for the intermediary who is the registered holder to collect diverse instructions from beneficial owners, reflect them accurately in proxy voting instructions passed to the company registrar, and obtain and pass back to the beneficial owners confirmation that the votes had been recorded.'[80] With a view to assisting the market to produce these solutions, three provisions were added to the Companies Act 2006. These are analysed in turn below. We will see that this enabling legislative regime did not deliver the desired result.

Under CA 2006, s 324 a registered 'member is entitled to appoint another person as his proxy to exercise […] his rights to attend and to speak and vote at a meeting of the company.' This would enable the custodian, who administers legal ownership of the shares, to appoint the ultimate investor as a proxy, enabling them to participate in shareholder meetings. In our interviews we learnt that custodians sometimes offer this service,[81] but retail investors use it only rarely.[82] Our interviewees explained that proxy voting services are often subject to limitations and to the payment of an expensive fee.[83]

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[78] The Company Law Review Steering Group, note 31 above, para 3.51.

[79] ibid.

[80] ibid., at para 9.6.

[81] Interviewees 2, 3, 12, 13, 16 and 17.

[82] Interviewees 2, 11, 12, 14 and 15. In addition, we were informed that proxy voting is used primarily by private investors.

[83] Interviewees 11, 12, 14, 15 and 16.

CA 2006, s 145 enables a company to make provisions in its articles for a member to nominate another person 'as entitled to enjoy or exercise all or any specified rights of the member in relation to the company.'[84] The provision only operates if the company's constitution permits this. In practice, companies have not used this provision.[85] This has been attributed to 'the complexity of arrangements required to administer this provision.'[86] We were told that issuers and their agents are too concerned about the integrity of the custody chain to accept a nominated individual as the ultimate investor.[87] This occurs despite the fact that CA 2006, s 145 does not require the issuer or its agent to make further enquiries once a nominee has been identified by a registered shareholder.

CA 2006, s 146 gives the right to a member of a company 'whose shares are admitted to trading on a regulated market' to nominate another person to enjoy certain 'information rights'. Information rights include 'the right to receive a copy of all communications that the company sends to its members'.[88] Unlike the right contained in CA 2006, s 145, this right is available on a statutory basis rather than on the basis of the company's constitution. The CGI has observed that CA 2006, s 146 'is not as widely used as it could be'.[89] This was attributed

[84] Under s 145, sub-section 4(a) CA 2006 the nominated person does not have direct enforceable rights against the company, as they can only enforce their rights through the members. This means that if the company does not respond appropriately (e.g. it does not accept the exercise by the nominee) it is the shareholder who retains the right of enforcement.

[85] Law Commission, Scoping Paper, note 3 above, para. 3.34 which was confirmed by interviewees 14 and 15. See also The Chartered Governance Institute, *BEIS Corporate Governance Reform Green Paper*, 2017 ("CGI Paper 2017") 2; the section was used, however, in *Eckerle v Wickeder Westfalenstahl GmbH* [2013] EWHC 68 (Ch) [2014] Ch 196; see also J. Payne, "Intermediated Securities and the Right to Vote in the UK" in L. Gullifer and J. Payne (eds) *Intermediated Securities. Legal Problems and Practical Issues*, note 4 above, 204-205.

[86] CGI Paper 2017, note 85 above, 2.

[87] ibid. Interviewees 14 and 15 told us that there are probably between 50,000 to 100,000 changes in shareholding made across the company register every day. Further down the chain, changes in shareholding can be even more numerous. Interviewee 11 pointed out that a way of mitigating these concerns would be to introduce an obligation on the nominated person to confirm to the issuer that their nomination is up to date.

[88] CA 2006, s 146(3)(a).

[89] CGI, *Response to the call for evidence on Intermediated Securities*, November 2019 ("CGI Paper 2019"), 11. See also UKSA, *Position Paper on Dematerialisation*, note 45 above, paras. 65-66.

to a perceived lack of interest from investors[90] and the failure of intermediaries to make this option available to their clients.[91]

Attempts by the Government to use enabling legislation allowing issuers (together with the respective financial services providers) to develop solutions which offer intermediated investors the full set of rights associated with their shares have failed. One proxy advisor told us that, if anything, intermediation has increased in most recent years.[92] Kathryn Judge observed that the increasing length and complexity of the financial sector has created 'new opportunities for intermediaries to earn fees, increase parties' tendency to rely on intermediaries, and obscure intermediaries' profits'.[93] As the structure of the market has further tilted towards intermediation since 2006, the Taskforce's suggestion to rely on market forces to achieve improvements would seem rather optimistic. We will see in the next section that legislative intervention can be successful in bringing about reform.

VI. SHAREHOLDER RIGHTS DIRECTIVE II

The Shareholder Rights Directive II has improved voting services for institutional investors.[94] The Directive affects UK service providers who serve customers in respect of shares of companies with their registered office in a Member State and admitted to trading on an EU regulated market.[95] We note that even in relation to institutional investors, who have bargaining power in their relationship with custodians, legislation was required to improve communication between issuers and ultimate investors. In this section, we use Proxymity and the Minerva-Nexus Model as case studies illustrating the improvements following the implementation of SRD II.

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[90] Interviewee 16 argued that failure to transfer information rights is not a major concern for investors, given that part of the information (e.g. annual reports) is easily accessible via the company website; see also BIS Paper, note 3 above, 73.

[91] Interviewees 14 and 15. Although there are indeed intermediaries who consider the service of passing information an integral part of their stewardship responsibility, there are many others who do not view this activity as a main priority.

[92] Interviewee 2.

[93] K. Judge, "Intermediary Influence" (2015) 82 U Chic L Rev 573, 580.

[94] E. Ferran, "Shareholder Engagement and Custody Chains" (2022) 23 European Business Organization Law Review, 507, 526-527.

[95] SRD II, note 6 above, articles 1(5) and 3e.

Proxymity is a computer system set up by a consortium of well-known service providers.[96] It was set up to facilitate compliance with the intermediaries' duties under SRD II.[97] We were told that as of September 2022, the firms committed to using Proxymity represent approximately 75% of the global assets under custody.[98] It does not remove intermediation or change the legal position of ultimate investors but connects issuers, intermediaries and investors and passes data (such as voting instructions, corporate information and shareholder disclosure requests) along the chain.[99] The collection of data in one single database does, nevertheless, make errors and discrepancies visible and rectifiable.[100]

From the perspective of this paper the system has two significant design limitations. It only improves voting and information sharing. It does not improve the ability of investors to enforce claims against issuers. In addition, the service is available only to institutional and high net-worth individual investors.[101] It has not been programmed to provide voting solutions for firms dealing with high volumes of individual investors.[102]

The Minerva-Nexus Model is another industry initiative set up in response to SRD II.[103] Its aim is to facilitate the exercise of corporate rights for securities that are used for lending, assisting all intermediaries in a chain with processing recall request rights. [104]

In this section, we have observed that the market for services facilitating the relay of information and the transfer of voting rights along custody chains between issuer and investors has seen technological advancements, enhancing service quality, in response to the

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[96] Including BNY Mellon, BNP Paribas, Citi, Clearstream, Deutsche Bank, HSBC, J.P. Morgan, Computershare and State Street.

[97]SRD II, note 6 above, articles 3a, 3b, and 3c; Proxymity, Your SRD II partner, https://www.proxymity.io/proxymity-products/srd-ii-solutions/ (last accessed 13 June 2024).

[98] Interviewees 14, 16 and 17.

[99] Computershare, Proxymity. A pioneering investor communications platform at https://www.computershare.com/uk/proxymity (last accessed 6 January 2024).

[100] Interviewees 14, 15 and 17; during the reconciliation process Proxymity can identify any potential 'mismatching' in the data collected along the chain and ask custodians to rectify their records.

[101] Interviewees 14, 15 and 17.

[102] Interviewee 17.

[103] Minerva Analytics, "Minerva Nexus Background Briefing: Sustainable Securities Lending" June 2021, 5, 6 and 8.

[104] Interviewee 2.

SRD II. This shows that legislative intervention is essential for fostering better connections between issuers and investors. We also note that the improvements are confined to voting processes. The SRD II has not aided investors in enforcing claims. Retail investors, who are outside the scope of SRD II, have not benefitted from this reform.

VII. WHY WE NEED REFORM

A. Introduction

We could conclude that the difficulty in accessing direct share ownership and the poor quality of intermediated share services should be accepted as a normal evolution of the market. Why should we care about the enforcement of claims against issuers? Why should we care about retail investors if their numbers are small and few of them vote?[105] The reasons why we should address both topics are set out below.

B. Shareholder preferences

It is possible that the lack of interest from retail investors in exercising their rights and the cost of providing these services are overstated. We have already mentioned that the absence of competition, combined with the lack of bargaining power of retail investors, could prevent infrastructure providers from developing business models that facilitate direct holdings of uncertificated securities at a reasonable cost and the supply of high quality services for intermediated accounts.[106]

We are not alone in suggesting that if retail investors had access to a straightforward way of exercising their rights, they might well be interested in doing so. Mark Austin wrote that there is a 'cogent argument' that the claims of market participants - that there is not sufficient demand amongst investors - create a 'self-fulfilling prophecy'.[107] Firms 'do not invest in easy

[105] J. E. Fisch, Standing "Voting Instructions: Empowering the Excluded Retail Investor" (2017) 102 Minn. L. Rev. 11, 12. See also G. Balp, "The Corporate Governance Role of Retail Investors" (2018) 31 (1) Loy. Consumer L. Rev. 47, 48 and BIS Paper, note 3 above, 74 and 82 and R. Uddin, note 71 above. However, see also E. Ferran, note 94 above, 509-510.

[106] See above section IV(B).

[107] SCRR, note 8 above, para. 10.67.

to use services or place high charges on them and do not actively market them'.[108] This leads to such services being unattractive or unknown to retail investors,[109] 'which is then used as a justification for lack of investment by intermediaries'.[110]

This observation is supported by recent developments in the US. Blackrock, having embraced environmental and social investment goals, came under political scrutiny and decided to back out of the ensuing political debate by announcing a system that gives clients the 'option to have a say in how proxy votes are cast at companies their money is invested in'.[111] We observe that, once incentives are in place, market practice can shift.

Finally, a generational shift is underway.[112] The demographic of those who hold shares is changing. Shareholders used to be almost exclusively white retired males. In the last few years, young and ethnically diverse investors have started to buy individual shares. These are not only growing in number but are also about to inherit significant sums of money from their parents and grandparents. They care about voting rights and exercise these not only in pursuit of financial gain but also to steer companies towards wider societal goals that they believe to be important. It would be wrong to design the mechanics of holding shares in a way that undermines the ability of this group of retail investors and (for that matter) any other individual who is (or will be) prepared to exercise rights as corporate shareholders.[113]

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[108] ibid, but see also R. Uddin, note 71 above.

[109] BIS Paper, note 3 above, 72 and 74.

[110] SCRR, note 8 above, para 10.67.

[111] Larry Fink's 2022 Letter to CEOs, The Power of Capitalism, at https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter (last accessed 6 January 2024) and L. van Marcke, "'Direct' Voting by Institutional Investors: A Trojan Horse?" March 2023 at https://blogs.law.ox.ac.uk/blog-post/2023/03/direct-voting-institutional-investors-trojan-horse (last accessed 6 January 2024). Since the launch, BlackRock has extended the so-called 'Proxy Voting Choice' programme to millions of U.S. retail shareholder accounts, J. A. Majeid and R. Aguirre, "BlackRock has expanded Proxy Voting Choice to millions of U.S. retail shareholder accounts", 1 April, 2024 at https://corpgov.law.harvard.edu/tag/proxy-voting/ (last accessed 29 April 2024).

[112] E. Ferran, note 94 above, 507. See also S. A. Gramitto Ricci and C. M. Sautter, "The Educated Retail Investor: A Response to 'Regulating Democratized Investing'" (2022) Ohio State Law Journal Online, 205, 207 at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4189670 (last accessed 30 August 2024).

[113] S. A. Gramitto Ricci and C. M. Sautter "Harnessing the Collective Power of Retail Investors", June 2022 in C. M. Bruner & M. Moore (eds) *A Research Agenda for Corporate Law* (Cheltenham 2023) at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4147388 (last accessed 6 January 2024).

C. Oversight for issuers

Secondly, the operational ability to vote and enforce claims against issuers is important for their governance. An argument is sometimes made that smaller investors (retail and institutional) are rationally apathetic. They face a collective action problem as the cost of exercising of their rights is not outweighed by the benefits.

The corporate governance literature, however, discusses rational apathy not as a desirable outcome but as a problem. There is debate about how much influence shareholders should have as compared to directors or other stakeholders such as employees.[114] Corporate lawyers discuss the fine tuning of these rights.[115] Shareholder oversight may not be as effective in controlling directors as some would hope, but the discussion in corporate law assumes that there are shareholders who have the uninhibited operational ability to make use of their respective rights.

Shareholders have the role of overseeing the directors of companies. They may not do so on an ongoing basis. But this does not mean that they are uninterested when fundamental decisions are taken that affect their rights.[116] Moreover, the ability of shareholders to exercise their rights sends an important signal to directors.[117] The fact that there are shareholders who can spring into action has a disciplining effect on the directors.[118] Along similar lines, Holger Spamann recently observed that 'gadfly' investors are an indispensable catalyst for shareholder votes on items not desired by either management or required by law.[119] He also pointed out that individual named plaintiff investors operate as figureheads in shareholder litigation, which forms part of an institutional ecosystem protecting the interests of all

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[114] For many see R. J Gilson, 'From Corporate Law to Corporate Governance' in J.N. Gordon and W.G. Ringe in *The Oxford Handbook of Corporate Law and Governance* (OUP 2015) 3, 15-25.

[115] For many see M.T. Moore and M. Petrin, *Corporate Governance: Law, Regulation and Theory* (Palgrave 2017) 75-79 and 91-96.

[116] BIS Paper, note 3 above, 83; E. Maddock-Jones, "Hargreaves Lansdown launches electronic voting system" Investment Week, 20 January 2023, at https://www.investmentweek.co.uk/news/4063096/hargreaves-lansdown-launches-electronic-voting (last accessed 6 January 2024).

[117] ibid; see also R.C. Nolan, "Indirect Investors: A Greater Say in the Company?" (2003) 3 J Corp L Stud 73, 101.

[118] M.T. Moore and M. Petrin, note 115 above, 96.

[119] H. Spamann, 'Indirect Investor Protection: The Investment Ecosystem and its Legal Underpinnings' (2022) 14 Journal of Legal Analysis 16 at 37.

investors, including those who hold through passive funds.[120] To perform this vital function, figurehead investors require standing in claims against companies. In the UK this means that their name has to be entered on the shareholder register.

In constitutional law, voters are also sometimes disengaged. Nevertheless, the government's knowledge that it will face the electorate from time to time ensures accountability. In a democracy, the argument that voters have different levels of competence and are sometimes passive does not justify removing voting rights or accepting a system that creates barriers to the exercise of these rights.

If small retail and institutional investors are blocked from standing in claims against issuers, the governance of companies will be exclusively overseen by large-scale institutional investors.[121] When institutional investing first rose to its current prominence, it was considered a welcome development. The expectation was that the institutionalisation of shareholding would lead to greater scrutiny of companies.[122] However, this has not been the case. The 2008 Financial Crisis has shown that the investment chain that operates between the ultimate beneficiaries of institutional investors drowns out the preferences of ultimate beneficiaries. While these have long-term goals, their service providers regularly respond to more immediate pressures. The current set-up of institutional investing transforms long-term goals into short-term signals.[123]

To increase engagement by institutional investors, the Financial Reporting Council has adopted the UK Stewardship Code.[124] The Code encourages (institutional) asset owners, asset managers and related service providers (such as investment consultants, proxy advisors, data and research providers) to exercise the governance rights they hold on behalf of their clients

[120] ibid.

[121] See also R. Uddin, note 71 above.

[122] G.P. Stapledon, *Institutional Shareholders and Corporate Governance* (Oxford 1996).

[123] UK Stewardship Code 2020 at https://www.frc.org.uk/investors/uk-stewardship-code (last accessed 6 January 2024). For a similar view see also Kay Review, note 17 above.

[124] UK Stewardship Code 2020, note 123 above.

in a responsible way.[125] There are signs that the market participants have accepted their role as stewards and are reporting on their stewardship activity.[126]

The fact that institutional investors are adopting the UK Stewardship Code and reporting accordingly does not mean that their activity leads to effective oversight of directors. Institutional investors are not acting for their own benefit. They watch their own bottom line. This undermines their ability to provide the required quality of oversight.[127]

Moreover, asset managers have come under fire for their dominance in markets. There is an ongoing academic debate as to whether asset managers (as the 'common owners' of large sections of the economy) have a negative effect on competition between their investee companies.[128] Given these uncertainties, it would be wrong to delegate the governance of companies to a highly concentrated industry whose impact on the economy we are only beginning to understand.

D. Summary

There is a cogent argument that a lack of competition, rather than a lack of interest by investors, is responsible for the market's failure to develop a cost-effective infrastructure that enables all shareholders to exercise their rights. In addition, corporate governance scholars express concern about rational apathy, but this does not lead them to recommend or condone the imposition of operational barriers for voting and exercising other shareholder rights. Indeed, the corporate governance literature stresses the importance of figurehead gadfly investors in corporate governance and litigation.

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[125] D. Katelouzou and D.W. Puchniak, *Global Shareholder Stewardship* (Cambridge 2022).

[126] FRC, *Research Study on the influence of the UK Stewardship Code 2020 on practice and reporting*, July 2022 at https://www.frc.org.uk/getattachment/de8c91f5-c2cb-4b8b-9a98-34c31f382924/FRC-Influence-of-the-Stewardship-Code_July-2022.pdf (last accessed 6 January 2024).

[127] R.J. Gilson and J.N. Gordon, "The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights" (2013) 113 Colum. L. Rev. 863.

[128] Organisation for Economic Co-operation and Development ("OECD"), *Common ownership by institutional investors and its impact on* competition, December 2017 at https://www.oecd.org/daf/competition/common-ownership-and-its-impact-on-competition.htm (last accessed 6 January 2024); European Corporate Governance Institute's ("ECGI") Law Working Paper N. 393/2018 L. Enriques and A. Romano, *Institutional Investor Voting Behavior: A Network Theory Perspective*, July 2018 at https://ecgi.global/categories/common-ownership (last accessed 6 January 2024). See also L. van Marcke, note 111 above.

VIII. SOLUTIONS

A. Introduction

If we accept that the absence of a competitive market, combined with the desirability of oversight for issuers, justifies reform, we need to discuss how this reform should be designed. We have already seen that the Digitisation Taskforce and the 'Industry' have each advanced models for the elimination of certificated shares. These will be analysed below.

With a view to improving intermediated services the Law Commission has recently set out five options. We have put these to our interviewees and will discuss them below. We will analyse the Digitisation Taskforce's proposal further and give our own view.

B. Eliminating paper

As mentioned at the beginning of this paper, the Digitisation Taskforce concluded that certificated shares should be eliminated 'as a matter of urgency' and that existing certificated shares should be transformed into intermediated uncertificated holdings.[129] We also pointed out that this transforms direct legal ownership into intermediated beneficial ownership.

We believe that the urgency for the elimination of paper certificates is overstated. The number of certificated shares in listed companies is relatively small.[130] We agree with ShareSoc and UKSA that "forced dematerialisation of the remaining certificated shareholdings is not being proposed to meet any real needs of certificated shareholders, since by and large they are happy with the current position ([o]therwise, they would already have dematerialised their shareholdings)."[131]

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[129] Digitisation Taskforce, *Interim Report* note 2 above, p. 10; L. Walters, note 11 above; J. Roberts and H. Lansdown, "Two potential drawbacks for holding share certificates", https://www.hl.co.uk/investment-services/insights/two-potential-drawbacks-of-holding-share-certificates (last accessed 13 June 2024) and Dematerialisation of Paper Share Certificates, https://brigroup.co.uk/dematerialisation-of-paper-share-certificates/ (last accessed 13 June 2024)..

[130] Law Commission, Scoping Paper, note 3 above, para. 2.11 and para. 8.6.

[131] Joint response from UKSA and ShareSoc, note 11 above, para. 8.

The Taskforce's proposal reflects the preferences of issuers,[132] registrars and other intermediaries.[133] The Digitisation Taskforce has neither quantified nor substantiated the cost associated with certificated shares. Arguably, most expense arises when investors trade their shares or when certificates are lost, stolen or damaged. In both cases, costs are passed to investors through (i) higher brokerage fees for trading and managing paper certificates,[134] and (ii) replacement fees for issuing new paper certificates in cases of loss, damage, or theft.[135] Some brokers also charge transfer fees when converting electronically purchased shares to paper certificates.[136] Once a share certificate is issued there are no more costs to brokers, issuers or anyone else and consequently investors pay no fees for holding a share certificate. Paper certificates are a highly cost-effective option for holding shares in the long term.[137] ShareSoc reports that typical holders of certificated shares are retail investors who have held their shares for a long time and who prefer direct ownership and value direct communication from companies.[138] Eliminating paper certificates would significantly affect them.[139] They would not only lose direct access to corporate rights but also become exposed to the risk of losses caused by the insolvency, negligence or fraud of any one of the intermediaries in the chain.[140]

We have reported earlier that under the 'Industry Model', certificated shareholders would receive a unique reference number for their shares instead of a paper certificate. They would also open an account with the issuer's registrar. The proponents of the model are reported

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[132] M. O'Dwyer, BP and Shell among UK companies mounting push to ditch paper shares', FT 21 July 2024 at https://on.ft.com/4cREs1O (last accessed 27 July 2024).

[133] Joint response from UKSA and ShareSoc, note 11 above, paras. 8 and 30. See also, The Lemon Fool, Shares, Investment and Personal Finance Discussions Forums, note 11 above.

[134] L. Walters, note 11 above.

[135] Ibid.

[136] The Lemon Fool, Shares, Investment Discussions Forums, note 11 above.

[137] Ibid.

[138] Ibid. See also ShareSoc, Dematerialisation of Shares – Certificates to be Abolished, https://www.sharesoc.org/sharesoc-news/dematerialisation-of-shares-certificates-to-be-abolished/ (last accessed 6 June 2024).

[139] SCRR, note 8 above, para 10.68.

[140] Law Commission, Scoping Paper, note 3 above, chapters 6 and 7 and joint response from UKSA and ShareSoc, note 11 above, paras. 27, 28, and 29.

to have said that investors 'would not be charged' for holding their investments but that 'fees for actions effecting transactions would remain'.[141]

This proposal is better for shareholders than that of the Digitisation Taskforce. It nevertheless puts investors in a position where they need to rely on registrars to give them access to the digital system through which they hold their shares, without necessarily being in a bargaining position to resist fee increases once certificated shares have been eliminated. ShareSoc and UKSA favour digitization in principle, provided that individual investors can continue to hold shares in their own name at reasonable costs.[142] The Law Commission also stressed that the overall cost associated with the model should be 'proportionate'. [143]

Both the Digitisation Taskforce and the proponents of the 'Industry Model' are confident that it is possible to eliminate paper certificates, trusting that the market can deliver a cost-effective dematerialised way of holding shares. We would point out that proof is in the pudding. If, despite the lack of competition and past performance, the market succeeds in developing an attractive uncertificated way to hold shares directly, there will be no need to abolish certificated shares. Investors will of their own accord take up that model. In recent years, we have all switched from predominantly using cash to almost exclusively using card payments, precisely because of the inconvenience associated with paper bills and metal coins. The market can instigate reform without the Government's help and, if eliminating paper is indeed urgent, it should do so at its earliest convenience.

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[141] Law Commission, Scoping Paper, note 3 above, paras. 8.82 – 8.83. Interviewees 14 and 15, with whom we shared a draft of this paper, contacted us to stress that a similar model operates in Ireland, which could be adapted to the UK and at a cost that would not result in extra fees for investors.

[142] Share Soc, *Press Release 122: UK shareholders welcome and support Treasury Report on Secondary Market Placings* at https://www.sharesoc.org/sharesoc-news/press-release-122-uk-shareholders-welcome-and-support-treasury-report-on-secondary-market-placings/ (last accessed 6 January 2024). In 2019 they also supported the Industry Model, ShareSoc-UKSA, Joint Response to the Law Commission's Consultation on Intermediated Securities, 5 November 2019, 24-25. However, they also point out that the consequences of dematerialisation 'very much depend on how the UK Government chooses to implement dematerialisation' as 'the issue is not the loss of paper certificates, the issue is how to ensure that private individuals can continue to own company shares', ibid. Sharesoc and UKSA believe that a central principle of implementing full dematerialisation in the UK 'must be the preservation of key elements of the existing share registration model for paper certification – albeit without the need for paper certificates', ibid. 9.

[143] Law Commission, Scoping Paper, note 3 above, paras. 8.82 – 8.86.

The Government should nevertheless intervene, but not by eliminating certificated shares. As we have mentioned, the fees for direct personal membership in CREST have recently increased steeply. CREST operates the only system in the UK for uncertificated securities. Only a very limited number of brokers offer sponsored CREST membership. The CMA has the authority to open an investigation, if it has concerns about service providers abusing their dominant position in the market.[144] The European antitrust regulator has recently investigated similar cases, which resulted in a settlement where Thomson Reuters, Markit, the International Swaps and Derivatives Association Inc., and others modified the terms for their main products.[145] We recommend that the CMA investigate the provisioning of CREST-sponsored accounts.[146]

C. Improving the intermediated holding model

1. Introduction

We have argued above that certificated shares should be retained to enable those who prefer to hold shares directly to do so at a reasonable cost. We also believe that intermediated holdings require reform. The legal and operational problems affecting the current market have been acknowledged by the Company Law Review Steering Group,[147] the Kay Review,[148] the (then) Department for Business, Innovation & Skill ('BIS'), the Law Commission, and, more recently, Mark Austin's Secondary Capital Raising Report ('SCRR')[149]. In 2016 the BIS confirmed

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[144] CMA, About us at https://www.gov.uk/government/organisations/competition-and-markets-authority/about#:~:text=we%20protect%20people%20from%20unfair,are%20competition%20or%20consumer%20problems (last accessed 6 January 2024).

[145] P. Stafford, "EC agrees deal with, ISDA, Markit over credit default swaps" FT, 20 July 2016, at https://www.ft.com/content/461b7347-0211-360c-acc9-6db84340c838 (last accessed 6 January 2024); European Commission, Press Release "Antitrust: Commission accepts commitments by ISDA and Markit on credit default swaps" 20 July 2016 at https://ec.europa.eu/commission/presscorner/detail/en/IP_16_2586 (last accessed 6 January 2024); European Commission, Press Release: "Antitrust: Commission renders legally binding commitments from Thomson Reuters" 20 December 2012 at https://ec.europa.eu/commission/presscorner/detail/en/IP_12_1433 (last accessed 6 January 2024).

[146] See also UKSA, *Position Paper on Dematerialisation*, note 45 above, paras 62 and 69.

[147] The Company Law Review Steering Group, *Modern Company* Law *for a Competitive Economy Final Report*, 2001, para 3.51 at https://webarchive.nationalarchives.gov.uk/20060215135312/http://www.dti.gov.uk/cld/final_report/ (last accessed 6 January 2024).

[148] Kay Review, note 17 above, chapter 3.

[149] SCRR, note 8 above.

that the voting process in custody chains is 'opaque' and 'of questionable accuracy'.[150] The UK Law Commission has, over an extended period of time, done work in this area evidencing the existence of significant and persistent problems.[151] Mark Austin concluded that the 'level of intermediation and specialisation has […] arguably become a barrier … for end users of the system.'[152] He also observed that the 'ability of underlying owners to exercise entitlements around voting or to participate in fundraises is not uniformly enabled across retail platforms' and that there can be 'breakdowns in information flows […] relat[ing] to voting at meetings and exercising entitlements in connection with a pre-emptive offer.'[153] We believe that the infrastructure through which the majority of investors hold shares should enable these investors to adequately oversee issuers.

2. Technology

We have explained earlier that the Digitisation Taskforce recommended a common messaging protocol. The Law Commission wrote that distributed ledger technology (DLT) could 'enable the creation of direct relationships between investors and companies',[154] but stressed that technology does not change the legal position of ultimate investors and will only enhance their rights where intermediaries are motivated to invest in it and use it for this purpose.[155]

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[150] BIS Paper, n 3, 18 and 119, 124 and 125.

[151] Law Commission, Scoping Paper, note 3 above. Previous work on intermediated securities includes Law Commission, Consultation Paper No 215, *Fiduciary Duties of Investment Intermediaries*, October 2013; Updated Advice: *The UNIDROIT Convention on Substantive Rules regarding Intermediated Securities*, May 2008; *Project on Intermediated Investment Securities. First Seminar: Objective for a Common Legal Framework*, March 2006; *Project on Intermediated Investment Securities. Second Seminar: Issues Affecting Account Holders and Intermediaries*, June 2006. See also the study on intermediated holding arrangements in respect of crypto-tokens undertaken by the Law Commission, *Digital assets: Final report*, Law Com No 412, June 2023, 148 – 182.

[152] SCRR, note 8 above, para 10.3.

[153] SCRR, note 8 above, paras. 10.63 and 10.64.

[154] Law Commission, Scoping Paper, note 3 above, paras. 9.67 – 9.69; see also SCRR, note 8 above, 19E and E. Micheler and L. von der Heyde, "Holding, clearing and settling securities through blockchain/distributed ledger technology: creating an efficient system by empowering investors" 31 (11) JIBFL 652, 654; see also P. Paech, "The Governance of Blockchain Financial Networks" (2017) 80(6) MLR 1073–1110; S. Green and F. Snagg, "Intermediated Securities and Distributed Ledger Technology" in L. Gullifer and J. Payne (eds), *Intermediated Securities and Beyond*, note 4 above 337-358 and E. Schuster, "Cloud Crypto Land" (2021) 84 (5) MLR 974 – 1004; but see Jurisdiction Taskforce, Legal Statement on "The issuance and transfer of digital securities under English private law" available from https://ukjt.lawtechuk.io (last visited 6 January 2024) and The Financial Services and Markets Act 2023 (Digital Securities Sandbox) Regulations 2023 (SI 2023/1398).

[155] Law Commission, Scoping Paper, note 3 above, para 9.76; see also paras. 9.52-9.54, for an excellent explanation of the technology see Appendix 4.

Our interviewees said that DLT has the potential to enhance investors' rights but requires a substantial transformation of the market and this takes time.[156] Two interviewees further pointed out that the development of DLT could also be adversely affected by the role played by the intermediaries in financial markets.[157] Intermediaries are unlikely to be interested in investing in the technology if it undermines their ability to generate returns.[158] Three of our interviewees felt that it was more realistic to expect immediate improvements from legislative intervention.[159]

A common messaging protocol will ensure that all intermediaries are aware which data points are relevant at other levels in the chain.[160] However, it does not prevent errors, which occur as information is transferred from one organisation to another. A standard messaging protocol also does not provide intermediaries with an incentive to provide the services of enabling the exercise of rights by shareholders.

We are not hopeful that DLT will change anything. We have seen above that custodians currently lack sufficient incentives to take advantage of existing technology to improve links between them. We doubt that they will invest in DLT. Moreover, the current opportunity for the use of DLT for this purpose appears to be going to waste. The Bank of England and FCA are jointly working on the Digital Securities Sandbox (DSS) aimed at supporting new business models for trading and settling securities based on developing technology, (such as DLT). They state that they aim to streamline the processes of issuing, trading, and settling securities and to reduce the need for intermediaries. But the current draft rules for service providers envisage outsourcing and consequently intermediation and do not require applicants to

[156] Interviewees 2, 4 and 17; see also A. Lafarre and C. Van der Elst, "The Viability of Blockchain in Corporate Governance" July 2023 at https://blogs.law.ox.ac.uk/oblb/blog-post/2023/07/viability-blockchain-corporate-governance (last accessed 6 January 2024).

[157] Interviewees 2, and 4.

[158] See also M. Mainelli & A. Milne, "The Impact and Potential of Blockchain on the Securities Transaction Lifecycle" (SWIFT Institute Working Paper No. 2015-007, May 2016), at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2777404 (last accessed 6 January 2024) and E. Micheler and L. von der Heyde, note 145 above, 652, 654.

[159] Interviewees 14, 15 and 17.

[160] This proposal did not exist when we conducted our interviews. Interviewee 11 nevertheless mentioned that a standardisation of communication between intermediaries would be useful.

provide avenues for investors to hold digital securities directly.[161] Disappointingly, the sandbox appears to be designed with a view to replicating the current intermediated market structure.

3. Legal Interventions

Proposals by the Law Commission and the Digitisation Taskforce

The Law Commission observed that no progress had been made since the Company Law Steering Group pointed out the problem,[162] and proposed that a statutory obligation be imposed on intermediaries to arrange, upon request, for an indirect investor to exercise shareholder rights.[163] Mark Austin endorsed this proposal.[164] Alternatively, the Law Commission suggested to draw inspiration from the SRD II.[165] SRD II contains provisions imposing on intermediaries a duty to offer companies the right to identify their shareholder, to pass information between the company and shareholders, and to facilitate the exercise of voting rights.[166] As a substitute to hard law, the Law Commission considered the introduction of a code of 'best practice principles'.[167] Along similar lines, the Digitisation Taskforce recommended a requirement for intermediaries to disclose their service levels.

In addition to facilitating voting, the Law Commission proposed to amend the Companies Act 2006 and the FSMA 2000 to enable ultimate intermediated investors to better exercise and enforce shareholder rights. This would entail, for example, changes to CA 2006, ss 98,[168] 899,[169] 633, 338, 570, and 571.[170] It would also involve clarifying FSMA 2000, s 90A.[171]

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[161] Interviewee 18.

[162] Law Commission, Scoping Paper, note 3 above, para 9.8.

[163] For detail see ibid., at paras. 3.81 – 3.105.

[164] SCRR note 8 above, 19; see also R. C. Nolan, note 116 above, 91-92.

[165] Law Commission, Scoping Paper, note 3 above, paras. 3.106-3.126.

[166] SRD II, note 6 above, article 3.

[167] Law Commission, Scoping Paper, note 3 above, para 9.2.

[168] The Law Commission considers two ways in which this provision can be reviewed: (i) removing the words "but not by a person who has consented to or voted in favour of the resolution" (thus allowing intermediaries to bring actions along the chain on behalf of ultimate investors), and/or (ii) granting ultimate investors the power to bring claims directly against issuing companies.

[169] The Law Commission proposes to remove the "headcount" test in CA 2006, S 899 and consider additional measures to enhance the protection of minority shareholders.

[170] Law Commission, Scoping Paper, note 3 above, paras. 10.6 and 5.75.

[171] Ibid.

Our interviewees

Our interviewees were against a best practice code.[172] They believe that hard law better enhances investors rights.[173] They also rejected the model adopted by SRD II,[174] favouring statutory intervention to impose obligations on intermediaries to facilitate voting and to amend the Companies Act 2006 and FSMA 2000. Most of them said that this solution would be a step forward to improve the practice of intermediated securities.[175] They observed that without the introduction of a formal obligation, intermediaries lack an incentive to make improvements.[176]

Our view

We have seen that the market promised to solve the problems of intermediated securities 20 years ago but has yet to deliver a solution. We argue that a lack of competition undermines service providers' ability to develop business models that better serve investors and issuers. We predict that infrastructure providers will, like they did before, express intentions to improve, only to find they lack sufficient incentives. Better transparency by intermediaries does not address their underlying incentives, and disclosure does not give small-scale investors the bargaining power to demand better service at lower costs.

The ability of the market to make promises of any kind is further undermined by the fact that the market infrastructure is constantly changing. These changes are frequently carried out through the outsourcing of activity.[177] One proxy voting advisor mentioned that fund managers are increasingly outsourcing administrative functions and compliance tasks (including voting activities) to third parties, which adds another layer of complexity to the

[172] Interviewees 2, 3, 5, 6, 7, 11, 14, 15 and 16. The Law Commission also pointed out that 'in general stakeholders were not enthusiastic about this approach', ibid., at para. 9.9

[173] Interviewee 11.

[174] See also SCRR, note 8 above, para 19-20.

[175] Interviewees 1, 5, 6, 7, 8, 9, 11, 14, 15 and 16; Interviewee 11 suggested that the obligation should be added the FCA Handbook.

[176] Interviewee 11, 6 and 7.

[177] Interviewee 2.

system.[178] This development is likely to continue.[179] From the perspective of this paper the effect of this is that any promises made by current market participants will not, of course, bind intermediaries to whom the activity will be outsourced in the future.

We note, further, that the recent improvements of corporate communication services occurred in response to the obligations imposed by SRD II rather than through voluntary industry-led improvements. We believe that it is unlikely that the market will succeed in creating a model that makes it possible for retail investors to exercise, at a low cost, the corporate rights associated with shares held through custody chains.

We mentioned above that our interviewees largely agree that a formal legal duty is necessary to improve intermediated holdings. We note here that there is a difference between saying that statutory intervention will help and volunteering to accept a formal duty imposed upon oneself.

We therefore believe that a duty should be imposed on intermediaries requiring them to assist their clients, who hold securities through a nominee account, to exercise their rights against the issuer of shares. We also endorse the Law Commission's proposal to clarify the wording of FSMA 2000, s 90A and to modify the Companies Act 2006. Further work will be needed to define ultimate investors for this purpose. This will not be straightforward,[180] but, as *Secure Capital v Credit Suisse* has shown,[181] other legal systems have been able to find a workable solution.

IX. SUMMARY

In this article we argue that paper certificates should not be eliminated. The industry does not need the Government to intervene to present retail shareholders with a cost-effective model for holdings shares directly. Instead of removing paper the Government should encourage the Competition and Market Authority to investigate the price structure for CREST accounts. We

[178] Ibid.

[179] K. Judge, "Intermediary Influence" (2015) 82 U Chic L Rev 573, 580.

[180] Interviewee 11.

[181] *Secure Capital SA v Credit Suisse AG* [2017] EWCA Civ 1486.

also believe that legislation is required to remove the barriers that currently prevent intermediated investors from voting and otherwise exercising rights against issuers.