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Dear Claire

BIS RESEARCH PAPER NUMBER 261

Exploring the Intermediated Shareholding Model

In relation to the recently issued analysis and our subsequent discussion relating to the intermediated shareholding model, I thought it would be useful to provide you with Computershare's comments on the research paper.

We read the paper with interest. We would be keen to understand the ultimate purpose of the paper, which was not entirely apparent in reading the document. We do however have some concerns with the analysis that we have sought to document below, particularly in the event that the analysis will be used to assist in formulating Government policy on future initiatives such as dematerialisation or enhanced pass-back of rights. The analysis does not reflect an entirely accurate view of the current shareholding model, and if relied upon without clarification may result in unintended consequences.

We recognise that the researchers had a difficult challenge in analysing the complexities of the roles of various stakeholders within a short timeframe. We hope that our feedback below can be used to refine the findings of the research and facilitate a more accurate representation of the technical aspects covered. The key issues that we noted are outlined below, in order of appearance in the report:-

1) The glossary section contains a number of weaknesses, and we wonder if these have influenced some of the inaccuracies in analysis and conclusion provided in the paper. Specific examples include:

    a. The definition of 'beneficial owner' is rather unusual and does not effectively capture the concept. There are a number of robust legal and market-accepted definitions already in the public domain. The concept of beneficial ownership as being someone who 'enjoys the benefit of owning' a share is vague and concerning.
    b. Similarly, we question the rationale behind the definition of CSDs. The definition provided could arguably not even apply to Euroclear UK & Ireland. Given the substantial efforts put into defining CSDs under the recent CSD Regulation, and the importance of contextualising the definition for the UK market structure given the focus of the paper, this is again concerning. It appears that this confused definition may have influenced the understanding of the researchers of the overall market structure for the UK, with implications for the analysis e.g. see below in (2) where the CSD is presented as part of the ownership chain.
    c. Similarly the definition of Corporate Sponsored Nominee is inaccurate. The Corporate Sponsored Nominee account holder does not receive access to shareholder rights per se – the terms of the arrangement place them in an *equivalent* position administratively/contractually but they are not legally recognised as shareholders receiving rights directly. For this paper, it's a clearly a crucial distinction.

d. Omnibus, pooled, segregated and designated account definitions are confusing and unhelpful to uninformed readers, and again we feel that this influenced some of the errors in the analysis.

2) The opening paragraph of the executive summary states that investment advisors, CSDs and registrars are part of the ownership chain. This is clearly inaccurate especially as it relates to the UK – perhaps the researchers have confused voting processes with ownership structures but this statement is likely to cause confusion to readers.

3) Page 24 makes reference to the US and indicates that it operates an immobilised model. Whilst this is accurate in relation to securities held via DTCC it is worth noting that the US also operates an 'on-register' dematerialised model (Direct Registration System or 'DRS'). This allows investors to obtain the benefits of holding securities in book-entry form without being tied to a commercial relationship with an intermediary, allowing investors to maintain a direct legal relationship with the issuer. DRS has been available since 1996 and allows investors to avoid any ongoing cost in holding securities, as the costs of their account administration are paid by the issuer. DRS eligibility is mandatory for all listed issuers although they may also make certificates available to investors. It is worth noting that we see an increasing trend towards use of DRS over certificates by individual investors.

4) Page 36 refers to administration charges on the part of the registrar for transferring shareholdings from one broker to another, which is incorrect. Note that whilst a fee may be charged by the broker/intermediary for facilitating the transaction, there is no separate fee imposed by Registrars relating to this function.

5) Page 51 talks about the number of holdings investors had on average. It states that one respondent had a single investment, whereas others had up to 10 or even more. Note that when separate studies have been done, we've found that people on average have something like 1.5 investments in shares. Most would only hold a single investment, with a minority holding more, and in very few cases many more. In our view the fact that the large majority of shareholders have very few holdings is a key factor for any dematerialisation solution and necessitates a very simple model that is easy to understand.

6) The section on shareholding models (pages 71-73) doesn't accurately describe the various nominee arrangements – it states that designated nominees are operated in the name of the beneficial shareholder, and that the beneficial shareholder name will appear on the share register. This is not true for any nominee arrangement which by definition necessitates that the shareholder's nominee is recorded on the share register. The same error is prevalent in the second bullet point on page 75.

7) Page 73 states that three in four brokers claimed they were willing to pass information rights back to shareholders in nominee accounts but is silent as to whether this is under the nomination arrangements in Part 9 of the Companies Act. Note that we have only a very small handful of brokers who provide us with information rights data on their underlying clients so we presume the arrangements referred to are predominantly a separate procedure where the broker passes on information, rather that arranging for communications directly from the Issuer.

8) For voting rights available on request (page 73) the paper states that, for brokers without online voting services, the client would need to write an email or letter for the broker to forward to the registrar. This isn't necessary and makes the process seem more complicated than it is. The registered shareholder (the broker in this instance) can either lodge a proxy instruction with the registrar or provide a letter of representation to the underlying client which can simply be brought by the investor to the meeting. Neither option requires supporting documentation to be forwarded to the registrar.

9) In the section on AGM attendance (page 74), reference is made to arrangement fees for facilitating attendance – it is worth noting that the beneficial holder can be appointed as a proxy,

which gives them the right to attend without the burden of producing a letter of representation. The nominee/broker could feasibly still charge for administration charges in relation to a proxy appointment but the feedback we usually hear is that such charges generally relate to their issuance of a letter of representation.

10) The final paragraph on page 74 also states that the proportion of retail investors attending AGMs is negligible but this is something that we would strongly refute – it may be true for retail shareholders that are served by intermediaries but that doesn't account for the retail shareholders directly registered. In our experience these holders make up the majority of general meeting attendees by number. In recent years we have seen an increase in the number of attendees bringing letters of representation or getting appointed as proxy by their provider, but it is still a minority.

11) The final paragraph on page 75 and the first paragraph on page 76 indicate that pooled accounts are beneficial because clients can trade at greater speed due to lack of paper. Note that this benefit of efficiency in trading and transfer applies to any form of dematerialised holding and is not in itself justification for a pooled account. As you will be aware the cumbersome arrangements for submitting paper will be overcome once the UK has implemented dematerialisation for certificated shareholders.

12) The fourth bullet point on the information rights case study (page 81) states that Investors are not made aware of the date of AGMs under the Part 9 nomination arrangements. Section 145 of the Companies Act (Effect of provisions of articles as to enjoyment or exercise of members' rights) includes the rights under section 310 (right to notice of general meetings) so all nominated persons will be notified of the AGM date. Perhaps the broker is simply arranging for the underlying client to be added to the mailing list but it is important to understand the distinction.

13) In the final section on page 90 reference is made in point 1 to the company's ability to identify the investor through the section 793 process, but this ability is not referenced in point 2. Of course, the Issuer's right to enquire on interests in their securities exists regardless, and the size of the fund is irrelevant.

14) On page 92, the registrar is referred to as an intermediary (fourth bullet point). In reality the company is responsible to administer its own register but employs the services of a registrar to act on its behalf in an agency capacity (as recognised on page 96). Consequently registrars are not part of the intermediary chain. Registrars act in the capacity of the issuer (as their agent) in fulfilling various administrative responsibilities towards the issuer's shareholders. We note that a discrete number of issuers continue to administer their share registers directly, and perform the same role as a registrar.

15) We strongly disagree with the statement on page 96 that registrar activity alone is not sustainable as a stand-alone activity and query the basis for this unfounded statement and its inclusion in the report. While we agree that some registrars have chosen to diversify their business operations, this is simply a common commercial strategy and does not reflect on the viability of the function of registrars.

16) Page 95/96 – The description of the registrar is missing some important duties and oversimplifies the role – Registrars perform many key responsibilities including but not limited to: -

- Reconciliation of the overall securities issuance
- Record keeping in relation to registration transactions: -
    - CREST transactions
    - Off market transfers
    - Changes of address
    - Death administration

    - Adding/amending bank mandates to shareholder accounts for the payment of dividends by electronic means
    - Validation and processing of 'paper interface' transactions – CREST Stock Deposits & Withdrawals
    - Etc
- Planning and administration of AGMs
- Distribution of dividend payments and subsequent reconciliation – including handling of associated elections and payment instructions
- Management of mailings/communications with shareholders
- Responding to shareholder enquiries, received from both certificated holders and CREST participants.
- Administration of corporate actions (IPOs/takeovers/mergers/capital reorganisations/rights issues/open offers/redemptions/conversions): -
    - Processing acceptances
    - Calculating entitlements
    - Fulfilment services
    - Etc.
- Provision of advice to Issuers regarding best practice in shareholder services, including innovation in response to new shareholder products

17) The final paragraph on page 98 states that neither portion of the register (CREST vs Registrar administered) provides much visibility or granularity with regard to beneficial owners of shares. In reality the portion administered by the registrar provides almost 100% visibility, and the opacity issue is almost exclusive to the CREST portion.

18) In the section on record dates for voting (page 124) there is some commentary regarding shareholders' inability to derive their actual voting rights. This issue only impacts those investors served by pooled nominee accounts, as investors who are served via a segregated account, or who hold directly on the register, can vote directionally (i.e. for or against in respect of their entire shareholding) and do not need to specify the number of votes on their proxy instruction. In a pooled nominee arrangement, the custodian should endeavour to secure directional voting instructions from underlying clients and lodge a proxy instruction based on the underlying positions at point of lodgement.

19) The first bullet point on page 124 states that an institutional investor is unable to check whether proxy votes have been received by the registrar prior to the meeting. Note that for instructions lodged via CREST the lodging agent is able to obtain an audit trail confirming that the instruction has been received by the registrar. Provided the number of shares instructed upon is less than or equal to the record date holding, this provides certainty that the appointment and instruction will be provided to the Issuer for use at the meeting.

20) Page 125 – The quote towards the end of the page from an investment manager talks about the consequences of stock lending and mentions "extra shares floating around the system". It is critical to highlight that any such 'inflation' of shares can only take place on the books of the intermediary and does not reflect an actual increase in the total shares on issue. Registrars are responsible for managing the securities issuance and reconciliation and we do not create additional shares in such circumstances; this issue does not impact the overall integrity of the issue. Where an intermediary does not update their client accounts to reflect a stock loan, their records will show client share entitlements in excess of the actual share position held by the intermediary. The CREST account, which records registered ownership, is not being balanced to the intermediary's records of the beneficial entitlement of its investor clients. This is another area where clear definitions and explanations are key to understanding the core problems in the intermediated holding system. We note that this issue is likely to be one contributing factor to over-voting of intermediary positions, due to the lack of reconciliation between registered share positions and client account entitlements.

21) The final paragraph on page 130 refers to a 'true record date' for Corporate Actions which confers the ability to participate. The intimation is that the record date for General Meetings is somehow different, which is incorrect.

22) Page 130-131: There is some confusion here between corporate actions and voting/meetings. It could be said that voting is similar to a corporate action, but the paper mixes terminology. On page 131 it refers to the "voting options" which include "elect", "do nothing" and "sell". This is confusing.

23) On page 132 the paper discusses potential for an earlier record date for voting. The high level of voting on UK PLCs is indicative that the relevant stakeholders have overcome the challenges associated with the timeline and we do not view it as a key barrier. While changing record dates may reduce operational pressures, particularly those that arise from the administration of proxy voting for omnibus accounts, and facilitate improved reconciliation of voting instructions against entitlement by market participants, we are concerned that there is a real risk that any changes to accommodate these operational pressures on one side may create unintended consequences. For example, it would also increase the risk of empty voting where holders voting on resolutions may not have an economic interest in the outcome and conversely disenfranchise more investors that make a purchase in the run up to the meeting. From an operational perspective it may require systems development to crystallise entitlements that are used to validate votes lodged; and further discussion with stakeholders would be required to assess their expectations. A change to record dates would also require legislative support to amend the Companies Act. We understand that one key driver of the concerns with the current record date structure relates to the disparity between record date and proxy cut-off, whereby for most meetings the proxy cut-off is usually at 11am on the day of the record date with voting entitlements being crystallised at close of business. This difference requires intermediaries to lodge proxies before close of settlement where final positions may be uncertain. In our view, much of the pressure that this generates would be alleviated by standardising proxy cut-off at the same time as record date, being close of business.

We trust that this feedback is helpful and can be used to supplement the analysis, especially where the report is considered for areas of policy review.

Please let me know if you have any questions.

Yours sincerely

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