DIGITISATION TASKFORCE – INTERIM REPORT

July 2023

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Executive summary

The Digitisation Taskforce was established in July 2022, as a recommendation taken forward from Mark Austin's Secondary Capital Raising Review. Its aim is to drive forward the full digitisation of the UK shareholding framework by eliminating the use of paper share certificates, and in general seeking to improve the UK's intermediated system of share ownership.

Since then I have engaged extensively with affected stakeholders across the sector to seek their view and to draw my initial findings. This interim report provides a set of potential recommendations for the government and seeks feedback across a number of key questions, ahead of the publication of a final report to be delivered within six months.

The potential recommendations are as follows:

1. Legislation should be brought forward, and company articles of association changed, as soon as practicable to stop the issuance of new paper share certificates.
2. The government should bring forward legislation to require dematerialisation of all share certificates at a future date, to be determined as soon as possible.
3. The government should consult with issuer and investor representatives on the preferred approach to 'residual' paper share interests and whether a time limit should be imposed for the identification of untraced Ultimate Beneficial Owners (UBOs).
4. Intermediaries should have an obligation, as a condition of participation in the clearing and settlement system, to put in place common technology that enables them to respond to UBO requests from issuers within a very short timeframe.
5. Intermediaries offering shareholder services should be fully transparent about whether and the extent to which clients can access their rights as shareholders, as well as any charges imposed for that service.
6. Where intermediaries offer access to shareholder rights, the baseline service should facilitate the ability to vote, with confirmation that the vote has been recorded, and provide an efficient and reliable two-way

communication and messaging channel, through intermediaries, between the issuer and the UBOs.

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

I will be conducting a period of open engagement over the next six months, ahead of delivering the final report to government. Feedback on the interim report should be sent to digitisationtaskforce@hmtreasury.gov.uk by 25 September.

Sir Douglas Flint

10th July 2023

Background and objectives

By way of a letter dated 22nd July 2022, HM Treasury wrote to confirm my appointment as the independent Chair of a 'Digitisation Taskforce', to drive forward full digitisation of the UK's current shareholding framework.

Creation of this taskforce was one of the core recommendations contained within Mark Austin's Secondary Capital Raising Review (SCRR), which aimed to find ways to make secondary capital raising processes more efficient and effective.

The review identified digitisation of the UK's shareholding framework as a key reform. It noted that 'digitisation' should encompass the eradication of paper-based processes, particularly paper share certificates, in the securities settlement infrastructure for capital markets.

Our remit

The objectives of the Digitisation Taskforce, as set out in our terms of reference, are to:

1) Work with stakeholders across the financial services sector to build consensus on change, to:

    i. Identify immediate and longer term means of improving the current intermediated system of share ownership. This will mean:

        - investors as beneficial owners are better able to exercise rights associated with shares which intermediaries hold on their behalf
        - issuers can identify and communicate more easily with investors as the underlying beneficial owners, including on secondary capital raising offers
        - efficiencies can be identified to reduce costs and time delays in the existing system

    ii. Eliminate the use of paper share certificates for traded companies and mandate the use of additional options to cheques for cash remittances.

    iii. Consider whether the arrangements for digitisation can be extended to newly formed private companies and as an optional route for existing UK private companies.

iv. Consider new processes and technology and set out a long-term as well as short- and medium- term vision of how shares will be held, settled, and administered.

2) Develop a timetable and plan for implementation of changes, and support progress.

3) Engage with the government and regulators on progress and advise on any legislative, regulatory or other changes that will be required to support the programme.

Structure and purpose of this report

This interim report sets out the work done so far towards these aims. It suggests some potential recommendations for government, regulators and market participants, in order to achieve full digitisation of the UK shareholding framework. It seeks feedback on these potential recommendations before a final report is published within the next six months. It also poses some questions which require further exploration, and which we would also appreciate feedback on ahead of the final report.

The report begins with a discussion of the work that has been done previously on this topic, what has changed since then and the lessons we can learn. It then moves onto the substantive issues, considering in turn:

- Potential routes to the removal of paper share certificates
- Alternative depository models for recording interests in shares, looking to the point in time when all shares would have been digitised
- Transparency and communication obligations in the intermediation chain between issuers and ultimate beneficial owners (UBOs)
- Issuer and investor services, including routes to expression and confirmation of shareholder rights
- Changes in company law that the government should consider to give effect to the above

Finally, we consider the next steps for this work and set out a realistic but ambitious timetable for implementation.

Guiding principles

At the outset we believed that it would be important to set guiding principles which we would use to assess the views of parties we consulted. We concluded that the following perspectives should be given precedence over others:

- The views and interests of the issuer
- The views and interests of the UBOs
- That there should be transparency in whatever arrangements exist in intermediating issuers and UBOs.

We found overwhelming support for the proposition that, once the design of the depository system that deals with the withdrawal of paper share certificates is settled, all other components of the intermediary framework should be determined by competitive forces. Throughout our work we were increasingly made aware of, and impressed by, the levels of innovation in service propositions for all elements of the existing framework, with providers responding to competitive opportunity. We believe it is important for this market-based innovation to continue.

Previous work and changes that could facilitate digitisation

The terms of reference stressed the objective to identify a set of co-ordinated and wholesale improvements which would benefit all market participants, with the ambition of developing a consensus view. While there was substantial agreement on the end destination, namely the elimination of paper-based processes and more expansive deployment of digital communication channels between issuers and UBOs, there were understandable differences of opinion on the steps required, their timing and the optimal design of the end point. Part of this reflected current and prospective competing business models that exist or are contemplated in the intermediation chain and in the issuer servicing models under review.

This is not a new problem. We knew before we started our work that this taskforce builds on a considerable number of previous studies and attempts to modernise the UK's securities settlement infrastructure and facilitate more universal access to, and expression of, shareholder rights. These previous studies, a selection of which are noted below, comprehensively analysed the issues in detail, identified the many challenges and impediments to reform and set out possible routes to a more efficient and less burdensome framework. However, for a variety of reasons, including the envisaged high cost of implementation and the thorny issue of where such cost would fall, these studies were unsuccessful in driving change.

Selected past reports covering dematerialisation and shareholder rights

- Law Commission, Intermediated securities scoping paper – 2020
- BIS, Paper No 261 Exploring the Intermediated Shareholding Model – 2016
- The UNIDROIT Convention on Substantive Rules regarding Intermediated Securities – 2008
- Project on Intermediated Investment Securities – Objective for a Common Legal Framework – 2006
- The Company Law Review Steering Group, Modern Company Law for a Competitive Economy Final Report 2001, para. 3.51

Given the existence of these past studies, we have not replicated the contextual background in this report – instead we have summarised the 'exam questions' they responded to. These include whether certain practices, such as the maintenance of both certificated and uncertificated shareholder registers, are required; how communications between companies and their investors and corporate actions can be undertaken more efficiently and effectively; and what changes to UK company law would be required to move to a more efficient and transparent framework.

At all times, we remained fully aware of the need to recognise the FCA's Premium Listing Principles (PLP). In particular, it is vital to the shareholding ecosystem that a listed company ensures that it treats all holders of the same class of its shares equally in respect of the rights attached to those shares, as recognised by the FCA's fifth PLP. The means by which a shareholder holds their shares should enable the exercising of voting rights attached to those shares in a straightforward way.

One study in particular concluded with recommendations that attracted broad support, but it did not follow through to an implementation plan. To avoid a similar outcome, we asked ourselves what has changed that should make us confident of successful implementation this time around. We concluded that there have been a number of changes to the landscape which should be helpful in meeting our objectives:

- The ambition of the government to maintain and enhance the position of UK capital markets, as evidenced by recent work such as the UK Listings Review, chaired by Lord Hill, the SCRR, and the 'Edinburgh Reforms'
- The implementation of the EU Central Securities Depositories Regulation ('CSDR') which mandates no new certificated issuance from 2023 and dematerialization of all traded securities by 2025 across the EU, and evidence of practical implementation of CSDR in EU countries
- Experience gained through the implementation of the EU Shareholder Rights Directive II ('SDRII') which sets out to strengthen the position of shareholders
- Significant technological advances, such as the use of modern communications technology to distribute content digitally to mass market customers

- The increasing use of, and familiarisation with, digital offerings such as digital payment methods, and increased public understanding of the enhanced security available through digitisation of financial transactions
- The significant increase in UK based shareholders using self-directed platforms to hold and trade UK listed shares, and increasing access to and expression of shareholder rights through these platforms, wealth managers and brokers
- The increased responsibilities now placed on regulated financial intermediaries to identify and screen UBOs against anti money laundering ('AML') and expanded 'know your customer' ('KYC') standards, and the emergence of industry initiatives to streamline facilitation of UBO rights.
- Increasing governance obligations on company boards to evidence higher levels of engagement with their stakeholders, and the increasing challenge of maintaining up to date and accurate records of shareholders' details via paper-based systems, with the resulting challenge for issuers to stay in contact with their UBOs.
- The low level of votes cast at Annual General Meetings by retail shareholders, with the resulting question of how much this is as a result of barriers in the voting process – arising through how securities are held - which can be easily removed.

In carrying out our work we have sought to consult widely to include all categories of parties engaged across the intermediation chain between issuers and UBOs, together with a selection of industry bodies that represent various members of these constituencies. We have sought to understand, without predisposition towards the possible conclusions of this review, the points of view of different stakeholders, including in particular those of institutional and retail investors, and both large and small issuers, as well as those who supply issuer and investor services.

Dematerialisation of existing paper share certificates

It has been a longstanding ambition of the UK to remove paper share certificates and processes from the UK's trading and settlement framework. Many of the past reviews cited above have examined, in detail, the benefits of so doing, as well as the practical and legal issues that would need to be overcome to do so. We do not repeat these analyses in this report.

So what has changed since these past reviews highlighted the benefits of eliminating paper based processes, and removing physical share certificates? As noted above, advances in technology, pressure to reduce complexity and cost throughout the share trading and settlement infrastructure, as well as the advancement of legislative changes globally to facilitate digitisation in other markets make it an imperative that the UK, as one of the leading global financial markets, is not left behind. Indeed, it should, if possible, take the lead - although, as shown by the recent experiences of the ASX in Australia in relation to the reform of its CHESS system, there are also not necessarily advantages in seeking to be the first mover. In any event, in a globalised world and global financial markets, any domestic system has to be compatible across jurisdictions.

During our engagement with stakeholders across the sector we received overwhelming support from issuers, and all sectors of the industry that support share trading and settlement, to the proposition that the UK should put in place plans to remove paper share certificates as a matter of urgency. We have not set out the administrative burdens and related costs of retaining physical share certificates, as these are well known, and no party consulted is arguing that the acknowledged inefficiency and cost is outweighed by benefits. Where there were areas of difference these related primarily to the timing and sequence of individual steps and whether legislation should contemplate a progressive approach or a 'big bang'. There were also differences of opinion as to where newly digitised shares should reside in a fully digitised ecosystem.

We consider the sequencing question in more detail below, the future model of a fully digitised architecture in the next section, and deal with the necessary legislative steps to enable digitisation later in the report.

There are essentially three issues on sequencing to be addressed:

- At what point does the UK legislate to prevent the issuance of fresh paper certificates –the *'flow'* issue
- At what point should legislation be introduced to mandate digitisation of extant certificates, and what interval of time would be required for this to be executed efficiently with appropriate public outreach – the *'stock'* issue
- What arrangements need to be made for certificated shares whose UBOs cannot be identified and therefore cannot be digitised on an attributed basis to an individual UBO – the *'residual stock'* issue

Currently, by law, shareholders can request their shares to be certificated and they can request reissue of a lost, damaged or stolen certificate. Companies can issue paper certificates for new issuance and shareholders in receipt of scrip dividends or participating in dividend reinvestment plans ('DRIPs') can take these distributions in paper certificate form. Shareholders can also sell part of their holding and request a certificate for the residual portion or can seek to sub-divide their holding into multiple ownership with fresh certificates issued to record each interest.

We see no reason why legislation should not be brought forward in short order to eliminate fresh issuance for any purpose at an implementation date in the near term – say, within six months – to allow shareholder communication on the changes and for shareholders to nominate the destination for future digitised issuance. In the absence of a direction for future digitised distributions previously taken in scrip or through a DRIP, issuers may choose to take powers to default such shareholders to take their dividends in cash.

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

With regard to moving the 'stock' of currently issued paper share certificates to digitised records, timing of this will depend upon a) the architecture of the future infrastructure, b) the time therefore required to communicate the actions required to shareholders and to set up the routing to move physical shareholdings to their future digitised destination of record. This is considered further in the next section but again we believe the government should bring forward legislation to require dematerialisation of all share certificates at a future date and, after consultation on the time required to make the change, confirm the impact date for the change.

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

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

As issuers work with their registrars to dematerialise the physical sub-register, a significant challenge will be how to deal with certificated shareholders of record for whom no current contact details are held. It is evident that a large volume of extant paper certificates originate from legacy holdings of older UBOs and through historic privatisations – for example, TSB/Halifax (now Lloyds Banking Group) British Gas (now Centrica) BT, National Grid; and from demutualisations – for example, Standard Life (now abrdn), Norwich Union (now Aviva). This is why the number of physical certificates is high, but the percentage shareholding represented by them in most companies is very small and declining. By way of example, abrdn has around 90,000 certificated shareholders of whom around 70,000 hold less than 2,000 shares (circa £4,000 or less in value at today's share price).

Most companies have active programmes in place to trace 'lost' shareholders, but given the small value attached to many of the privatised/demutualised share certificates it is understandable that through the passage of time certificates have been lost, the original UBO has moved address, or has died without their shareholding being known to those concluding their affairs. In abrdn, for example, there are some 80,000 shareholders (both certificated and in the company nominee) who are no longer contactable, despite several efforts initiated by the company to try and keep in touch, via for example tracing programmes.

Without doubt, digitisation, with appropriate publicity and drive, will provide a fresh opportunity to identify currently uncontactable shareholders and restore control of their holdings to them. It will also provide an opportunity to update certificated shareholder records to include electronic means of communication, e-mail addresses or phone numbers for SMS messaging. However, it is also the case that many shareholders will remain untraceable and the question arises as to what to do with their interests. Three obvious possibilities exist:

- For issuers, or an agent on their behalf, to maintain a nominee account for such holdings with the responsibility to continue - for a reasonable time - to seek out UBOs
- To seek shareholder approval within the articles of association that such 'residual' certificated shares, once dematerialised, are sold in the market with the issuer retaining the funds in a segregated account to return to shareholders who ultimately identify themselves within a set period, possibly aligned to the period after which unclaimed dividends are forfeited
- Finally, the option exists to transfer all or a portion of the proceeds of dematerialised shares without identified UBOs to an authorised reclaim fund under the UK's Dormant Assets Scheme, (a scheme which seeks to reunite people with their unrecognised financial assets and where this is not possible, for the money to be used for 'good causes'), but with the obligation of the scheme to compensate UBOs who ultimately come forward with a valid claim within a prescribed time limit.

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

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

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

Design of a fully digitised share model – alternative depository models

As noted above, we found strong support for the removal of paper shares and paper processing for trading, settlement and record keeping. There were, however, a variety of views on the architecture of the prospective fully digitised infrastructure. Four models were highlighted:

1) Essentially a digital version of the current system, where a subsidiary register in digitised form is maintained by an intermediary, typically the current registrar. This would involve electronic transfers between this register and the central securities depository ('CSD') in which all currently dematerialised shares are recorded and settled post-trade (in the UK this is the CREST system operated by Euroclear UK & International). The advantages put forward for this option are as follows:

    - It replicates the current system, so is familiar to paper-based shareholders
    - It preserves a choice currently available to shareholders to be on a register other than that maintained by the CSD
    - It builds on linkages already in place between registrars and CREST
    - It obviates the need for certificated shareholders to identify and go through KYC procedures with a nominee to hold and administer their dematerialised interests. We note that many certificated shareholdings are modest in value and so the UBOs of many certificated holdings may not be of much interest to the platforms they might seek to join
    - It was asserted by some stakeholders we spoke to that this would be a lower cost option than the alternatives below.

    However, it retains one aspect of the current system that many of those consulted wish to see removed – a second register of shareholdings, with consequential friction as shares move between the two registers.

2) A second alternative would be to enhance the ability of certificated shareholders to become direct members of CREST. The advantage of this would be that the individual shareholder would remain directly on the issuer's share register in their own name, as they were as certificated shareholders. However, in this case the shareholder would need to seek a sponsor to manage their account with CREST and so this would be a high-cost option for typically low-value shareholdings. Additionally, we note that

there are increasingly few direct members of CREST, and the platforms we consulted with advised they rarely see any interest to do so.

Accordingly, we do not see this as a viable option, due to the costs involved and the lack of any meaningful support.

3) The third alternative would be to mandate all certificated shares to be moved to the CSD, intermediated and administered through a nominee. This is the model through which the vast majority of digitised shares are currently held and administered. This would bring all shareholdings into a single CSD, removing the need for movement between sub-registers and the CSD. It would, however, require all certificated shareholders to identify and be accepted by a nominee to act on their behalf.

   We believe this represents the leading model for digitisation of paper certificates, especially when enhanced by the improved transparency and communication obligations recommended later. We will test this further in the second phase of our work. We have not found any evidence that certificated shareholders, once dematerialised, would have a preference as to whether their interests are held through the CSD or recorded in a sub-register outside the CSD – their original preference was simply to receive a paper certificate. If this is to be the preferred model for digitisation it will require currently certificated shareholders to be intermediated by a nominee of their choice or, in the first instance, a nominee arrangement facilitated by individual issuers or a centralised nominee.

4) The fourth model suggested was to re-imagine the securities holding, trading and settlement framework, stepping beyond current infrastructure to envisage the possibilities that would arise from adopting Distributed Ledger Technology ('DLT'). Under this model, all transactions and actions would be confirmed by all parties on inception, which would remove the need for many of the current reconciliations and communications running through the intermediation chain.

   It is difficult to fully assess the possibilities, advantages and risks arising from a step change to DLT architecture in this review, given that the technology is still at an early stage of development and adoption. At the outset of our review, we determined that our ambition was to bring forward practical steps to improve the current architecture of share registration, trading and settlement, together with enhancing access to and expression

of shareholder rights, all in the near term. We consider that any progress, after years of false starts in this area, is better than no progress, and we need to be realistic about what is achievable immediately. We are aware that HMT and other working groups inside government, as well as at the FCA, are exploring the possibilities that DLT would unlock.

We are also mindful that in Australia the proposed replacement of the CHESS clearing and settlement infrastructure (the Australian equivalent of CREST) using DLT was cancelled after several years of implementation planning and estimates of some AUS$500million of expenditure. The project failed due to its scale, complexity and transition challenges. The UK clearing and settlement infrastructure handles significantly more volume that its Australian counterpart, so the timescale to contemplate a re-platforming to a new technology should not be underestimated. We are sure that its time will come, but this is likely to be beyond the envisioned timetable for the implementation of the recommendations of this report.

In the 'Next steps' section, however, we suggest that in the second phase of this taskforce's work there is an opportunity to explore further where adoption of DLT could be beneficial to enhancing UK market infrastructure and competitiveness. We would also observe that transition to DLT would be greatly facilitated by all UBOs having a digital identity, a step again well beyond the scope of this report but one which an increasing number of commentators highlight as advantageous for online security and identity protection. There will also be the important question of interoperability across jurisdictions and markets to consider.

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

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

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

Transparency and communication obligations in the intermediation chain between issuers and UBOs

Two of the core objectives of this review under its terms of reference were to identify immediate and longer term means of improving on the current intermediated system of share ownership so that:

- Investors as beneficial owners are better able to exercise rights associated with shares which intermediaries hold on their behalf
- Issuers can identify and communicate more easily with investors as the underlying beneficial owners, including on secondary capital raisings

The first and enabling step is the dematerialisation of all shareholdings so that the entire chain can be linked electronically to facilitate two-way communication at limited cost. This will require a common messaging protocol that enables messages to be distributed easily in both directions.

It is a given that all shareholders have rights which they are entitled to exercise, and it is also the case that some shareholders may choose not to do so, while others may allow third parties to exercise their rights on their behalf. So there will be circumstances where the registered shareholder is the beneficiary of the rights directly, others where the registered shareholder is an intermediary where the underlying UBOs wish to exercise their rights, or alternatively have delegated their rights to the intermediary to exercise, or not, on their behalf.

There are many models in practice where the UBO is happy to have their rights exercised by the intermediary – in large part a combination of disinterest or lack of expertise – or in many cases that agency is part of the attraction of being intermediated by an expert. In other cases, the individual UBO exercise of rights is very important to the UBO, particularly with regard to corporate actions and ad hoc resolutions in areas of personal interest such as climate change transition planning.

Given that shareholders have undisputed rights, the question then arises as to whether providing the ability to exercise those rights in an intermediated model should be mandated in relation to all intermediaries, or not. If not, market forces can offer alternatives so that those UBOs who opt for a full service proposition with facilitation of exercising their rights can do so, while those happy to allow rights to be exercised on their behalf, or not exercised, can opt for a lighter touch service. We noted competition was working well in

this regard during the conduct of our consultation, as the three major retail-focussed platforms all offered access to voting rights within months of each other.

We also noted that the addition of access to voting rights did not incur additional charges, suggesting that such facilitation is not currently burdensome on intermediaries with good underlying technology platforms. It should, however, be noted that few retail shareholders in practice take up the ability to express their rights, although the upwards trend in those doing so is encouraging. A further improvement that was commented on by many consulted was the provision of confirmation to those voting that their votes have been received and cast as instructed – we believe in a digitised world this should be eminently possible without much, if any, additional cost. Where there is a cost that is to be charged or recharged this should be made clear.

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

In a fully digitised world, two-way communication between issuers and UBOs should be possible, and in our opinion should be enabled by mandating a common communication protocol throughout the intermediation chain. We were made aware that there are distinct differences of opinion amongst issuers regarding the benefits to be derived from opening a communication channel – for obvious reasons it is of more interest to issuers whose shareholders are also likely to be customers, as opposed to issuers operating in business-to-business markets. Recent hybrid AGM activity has also been instructive regarding communicating ahead of AGMs and gathering shareholder questions to be addressed at the AGM.

Of course, two-way communication depends on not only knowing who your registered shareholders are but also, in an intermediated chain, who your UBOs are. We set transparency as one of our core principles at the outset of our review and believe issuers should have the right to navigate the intermediation chain to identify UBOs. We believe that, given the obligations now placed on regulated financial intermediaries to have done due diligence on their customers (e.g. KYC and AML), UBO information is available throughout the chain and similar transparency is required under SRDII. Today the process to

collect UBO information requires a multi-layered back and forth between the issuer and the chain of intermediaries under the section 793 process in the Companies Act – this is costly and slow. When all shareholdings are digitised, and a common framework of communication and messaging is put in place, it should be eminently possible for issuers to seek information on their UBOs in a timely and cost-efficient way. We believe intermediaries should have this obligation placed on them as a condition of participation in the clearing and settlement system, and to put in place common technology that enables them to respond to UBO requests from issuers within a very short timeframe.

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

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

The other question that arose during our discussions on transparency of UBO information is who should have access to share ownership information in a digitised system. Currently shareholder information contained in the company's share register is publicly available on request, subject to meeting certain conditions, but only to the level of what is recorded on the share register. This will largely be in respect of institutional shareholders, custodians and nominees, as well as certificated retail shareholders. A public company is also required to keep a register of information received by it under s793, and to keep that register available for inspection where relevant conditions are met. We considered whether further granularity down to the level of UBOs should be publicly accessible and we concluded that it should not, given privacy concerns and the possible unintended use of that information.

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

Facilitating access to shareholder rights

One of the notable improvements evident in recent times has been the greater facilitation of access to retail shareholder rights through brokers, wealth managers and the major retail platforms in the UK. There should be no distinction in access to rights between shareholders who are directly registered and those who hold their shares through intermediaries. As we are recommending that certificated shareholders should be digitised and their interests represented through a nominee structure, if we do not facilitate access to expression of their rights we would be removing access to rights that these shareholders currently enjoy – this would be a retrograde step.

However, as we noted above we do not believe that it is necessary to mandate an obligation on every intermediary to offer access to UBOs for expression of their rights as long as they are transparent that this is their service proposition. However, the rights foregone should not be exercisable by any other party without the express consent of the UBO.

Where shareholders opt to be served through a service proposition which facilitates expression of their rights we believe a baseline service level should offer the following:

- Ability to vote
- Confirmation that voting instructions have been received and actioned as instructed
- A two-way communication channel between the issuer and the UBO
- Opportunity to participate in secondary capital offerings
- Ability to receive shareholder notices and documentation digitally
- An easy facility to keep shareholder details up to date so that the issuer does not lose track of shareholder contact and bank details.

It goes without saying that all communication and document flows should be electronically delivered. In the next section we propose that company law be changed to make digital distribution of documents the default option with shareholders having to opt in to receiving physical copies.

Digitisation also brings the opportunity to bring the ‘Deemed agreement’ (also known as ‘Deemed consent’) provisions of the Companies Act up to date both with actual behaviours over the 14 years since it was introduced, and with evolving and developing practices in electronic communications.

The current provisions allow companies to deem agreement by shareholders to receive communications by way of a website, rather than having to send the documents to shareholders. Companies must contact shareholders to allow them the opportunity to receive paper documents. In the absence of any response within 28 days, the shareholder is taken to have agreed that the company may 'send' or supply documents by way of a website.

However, the current provisions still require companies to notify shareholders individually of the presence of the relevant document or information on the website. If the shareholder has not requested this by the means of electronic communication, then this must be done by paper/post. A change to the provisions such that those in the 'Deemed consent' category would only be notified by electronic means (and would be required to provide appropriate contact details, which could be email address or mobile phone details) would result in significant time and cost savings for issuers and align with increasing expectation of information dissemination by electronic means.

A practical example – abrdn plc

By way of illustration of the benefits that this would provide:

- abrdn has 996,000 shareholders (88,000 directly on the register and 908,000 on the company-sponsored nominee).
- Of these 96,000 are in the 'gone away' category and so can be discounted from the perspective of communications. 398,000 have provided an email address and elected for electronic communications. They receive an email notifying them of the publication of documents on the company's website and links to an online voting facility.
- 34,000 have specifically requested paper communications and receive their documents by post. The remaining 468,000 are in the 'Deemed consent' (via a nil response) category, however, the company is still required to prepare a communication to this population and to print and mail them a notice advising of publication of documents on the company's website.
- The distribution of the AGM notice to the 502,000 shareholders of abrdn requiring a physical notice requires three weeks to execute* at a cost of £520,000, whereas placing the notice on the company's

website and messaging shareholders that it was there would be virtually cost free.

- Of the 900,000 shareholders sent the AGM notice, 98 attended the AGM - 57 in person, 41 via webcast and 34,885 shareholders voted on any resolution.

*An (abrdn) AGM mailing comprises 1.6m individual printed items and 6.65m printed pages. The timescale is related to the printing, insertion into envelopes and mailing of these items, including test prints of all scenarios, live proofing of personalised details, and reconciliation of all items mailed.

We also believe that once every shareholder is represented by a digital entry via a nominee it should be easier to mandate the default option for dividend and other distributions to be via direct deposit in the UBO's bank account eliminating another burdensome paper-based process which adds to reconciliation requirements. Given that individuals change their email addresses and their bank account less frequently than their physical address, we believe this would be to the benefit of all parties, accelerating the receipt of monies into a UBO's account and lowering the use of paper and the cost of administration on issuers.

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

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

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

Legislative changes required

In this section we outline certain areas in which legislative or regulatory change would be required to implement the recommendations made above. It does not purport to be comprehensive and brings together references to the legislative changes required referenced elsewhere in this report. We welcome input on how best to implement the recommendations through the current legislative and regulatory framework, and feedback in this area will help us to refine our proposals through the second stage of our work.

Recommendation 1 was to take steps to prevent the issuance of new paper share certificates, as required at present by a number of provisions in the Companies Act 2006 (CA 2006).

The Uncertificated Securities Regulations 2001 (USR 2001) currently enable shares to be evidenced and transferred within the UK's CSD, CREST (the USR 2001 have effect as if made under s784 CA 2006).

Section 786(1)(b) CA 2006 allows regulations to be made that go further and require companies (or a designated class of companies – for example public limited companies) to adopt arrangements for shares to be held and/or transferred without a written instrument. This provision could be used to effectively extend the scope of the USR 2001 and prohibit the issue of paper certificates by relevant companies, mandate use of CREST and disapply inconsistent provisions in a company's articles of association.

Recommendation 2 was to require dematerialisation of all share certificates at a future date. Under our currently preferred third option this would be done by mandating the transfer of all certificated shares to the CSD, intermediated and administered through a nominee.

Intermediation through a nominee requires legal title to the shares to be transferred to the nominee – the former holder of the share certificate retains beneficial ownership only. Although use of the powers discussed in relation to Recommendation 1 would seem to be a straightforward way to achieve this goal, s786(3) CA 2006 provides that such regulations cannot be used to change the person entitled to have their name entered on the company's register of members. This recommendation may therefore require an amendment to primary legislation. Any provisions governing mandatory transfer of the legal title to certificated shares would need to strike a fair balance between the

legitimate aims of digitisation and the impact on the rights of holders of currently certificated shares, and to comply with Article 1 of Protocol 1 to the European Convention on Human Rights as incorporated into domestic law through the Human Rights Act 1998. **We welcome feedback on this aspect of the recommendations in particular.**

Recommendation 4 was for intermediaries to be required, as a condition of participation in the clearing and settlement system, to put in place common technology that enables them to respond to ultimate beneficial owner (UBO) requests from issuers within a very short timeframe. One mechanism to implement this recommendation could be to update Schedule 1 to the USR 2001, which sets out matters that the operator of a relevant system (in the UK, CREST) must require in its rules and practices. Any requirements would need to apply throughout the chain of intermediation to ensure that messages were capable of reaching the ultimate beneficial owner. This may be facilitated through changes to the FCA Handbook, for example its Conduct of Business or Client Assets rules.

Recommendations 5 and 6 are for intermediaries offering shareholder services to be fully transparent about the extent to which they facilitate their clients accessing their rights as shareholders, and where they do the charges imposed for that service, and to establish a baseline service level where intermediaries choose to offer access to shareholder rights. Again, these changes could potentially be implemented through amendments to the FCA Handbook.

Recommendation 7 above is to withdraw cheque payments and make the default option for payments to shareholders direct payment into the nominated bank account of the ultimate beneficial owner. The methods that can be used to pay dividends are ordinarily set out in a company's Articles of Association. We would expect primary legislation to be required to override or mandate change to payment provisions for existing companies, and to amend the CA 2006 Model Articles for new incorporations. Withdrawal of cheque payments to shareholders has increasingly been carried out by issuers without significant protest and making this mandatory will further incentivise the furnishing by UBOs of their digital information where not already provided.

Next steps

This interim report sets out high level considerations to give effect to the digitisation of certificated shareholdings, to enhance the means of communication between issuers and the ultimate beneficial owners of their issued share capital and to facilitate greater ability of retail shareholder to exercise their rights through voting their shares.

In the next phase, after consideration of feedback, we intend to seek feedback on the interim report and go into more detail on the practical steps needed and the related timescale for implementation.

We also suggest that it would be helpful to explore how DLT might be deployed in the future. This could include how DLT may be used to maintaining registers of private market securities' interests and for tokenisation of funds, including debt instruments, in part to expand market access to a wider range of financial instruments to retail investors at lower cost.

We also note ongoing work being conducted through the Accelerated Settlement Taskforce to examine the potential for the UK to move to a faster settlement cycle, such as 'T+1', and reflect that the recommendations within this report would support this ambition.

We welcome feedback on this report and on the questions posed. Comments should be sent to digitisationtaskforce@hmtreasury.gov.uk by 25 September. A follow up report taking account of comments received, and setting out the final recommendations, will be issued within six months.

Sir Douglas Flint

10th July 2023