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European Commission

By email: markt-consultation-long-term-financing@ec.europa/eu

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Dear Sir/Madam

Response to the Green Paper on Long Term Financing of the European Economy

The Institute of Chartered Secretaries and Administrators Registrars Group ("the Group") is the representative body for all the main service registrars (issuer agents) in the United Kingdom and Ireland. The Group's members are registrars for more than 99% of all quoted companies in the UK and Ireland. The Group is responsible for formulating policy and best practice guidelines in all areas relating to share registration.

Our members perform a critical role in the interaction between companies and their shareholders and, in particular, the manner in which information and benefits are disseminated to investors by companies and the exercise of rights by those investors (e.g. voting and participation at general meetings and corporate events). This relationship is of acknowledged importance in your Green Paper and we have restricted our comments to those elements which impact on the services our members provide.

Q21 What kind of incentives could help promote better long-term shareholder engagement?

Both the Group and the UK and Irish issuers they service recognise the importance and value of effective long-term shareholder engagement and our members and their clients have been progressive in this area. The suggestion has been made in your Green Paper that "*options around granting increased voting rights or dividends to long-term investors*" might have a role to play in promoting better shareholder engagement. We have chosen not to take a stance on the corporate governance merits of this argument, but as service providers who would be instrumental in effecting any such schemes on behalf of UK and Irish issuers, we have instead concerned ourselves with highlighting the practical implications and challenges of delivering such incentive programmes with the required degree of integrity. We would be delighted to work with the relevant authorities to explore possible ways to overcome these.

We would make the following points in this regard:

- We believe that key stakeholders – corporate issuers and long-term investors – share a concern to ensure that any long-term investment incentives are allocated and administered in a transparent and auditable manner that ensures integrity in the administration of shareholder rights.

- As stated above, we have chosen not to take a stance on whether incentives will alter shareholder decisions as to whether to sell or engage. We believe other factors are important, such as the development of an investor code, the role of proxy advisors and the ability for issuers to determine who their investors are. To this final point, we support the TARGET2-Securities (T2S) task force findings and recommendations on transparency.

- Incentive initiatives create a divergence from the common governance standards of 'one share, one vote' prevalent in UK and Irish markets. They also run counter to rules requiring all shareholders to be treated equally, including Article 4 of the Shareholder Rights Directive (2007/36EC) which states "The company shall ensure equal treatment for all shareholders who are in the same position with regard to participation and the exercise of voting rights in the general meeting."

  Given the potential of incentives to alter the benefits enjoyed by some shareholders relative to others, we question whether such programs would need to be approved by the shareholders of the company, even if the relevant legislation/rules listed above were to be amended to cater for such programs.

- The central issue driving the ability of issuers and their agents to administer any form of incentives for long-term shareholders effectively is the degree to which they have visibility of the ultimate investor sitting behind the registered shareholder, if the shareholder is not the beneficial owner. Without this direct visibility, the issuer is not able to validate that the investor has held the shares for the requisite period, or to allocate the differential entitlements. A prerequisite for the effective delivery of any incentive scheme would be to ensure market infrastructure, systems and processes are in place to support the identification of duration of ownership 'below' the registered holder level. We see a number of specific barriers which would need to be overcome, including:

Intermediary Omnibus Accounts - Where an intermediary pools the assets of multiple investors within a single omnibus account, it is not currently feasible to track long term ownership. The intermediary does not pass details of underlying positions up to the issuer and will often internalise transactions between underlying holders so it is not possible to differentiate long term investors from short term ones. The prevalence of intermediary chains (which can often be several layers deep) exacerbates this problem, where the beneficial owner who is the economic investor in the securities may be obscured by several layers of intermediaries. Thus identifying the investor for purposes of measuring duration of ownership, and allocating differential rights based on that duration and thereafter facilitating the exercise of these rights through the levels of intermediation is not currently possible.

One possible approach to address the issue of omnibus accounts would be to enforce account segregation at the highest level, i.e. at the account level in the CSD so that the holding appeared directly on the register, and ban the use of omnibus accounts. However, we note that the practice of omnibus accounts is entrenched through all levels of intermediaries, from the top level CSD participants through any custodians and sub-custodians, and account segregation would need to be applied throughout the holding chain. We also note that even in a segregated account that is active in trading the problem remains, albeit on a lesser scale.

Requiring an alternative model involving account segregation at the highest level, i.e. at the account level in the CSD so that the holding appeared directly on the register, would necessitate a changes to UK law and market practice. We note that Euroclear UK & Ireland, the CSD for the UK and Irish markets, already supports the optional creation of segregated accounts and that the draft CSD Regulation is expected to require all EU CSDs to similarly allow account segregation.

Collateralisation - Liquidity is vital in the efficient running of European markets and any drive for long term investment must be balanced with the benefits of highly liquid markets. Collateralisation through stock lending, repos etc poses a significant challenge because there are no existing mechanisms available to an issuer or their agent for tracking such activity in relation to a long term holding. When stock is lent, the shares are transferred to the borrower, who thus becomes the owner of the shares and acquires the associated rights until such time as the equivalent number of shares are returned (transferred back) to the lender. The length of the stock loan can vary between an overnight arrangement and several years. Even identifying the transaction as a loan can sometimes be difficult (especially in T2S). In an environment where differential rights are allocated based on tenure of ownership, it needs to be considered whether the transfer of shares pursuant to a stock lending arrangement terminates the lender's period of ownership of the shares; or whether the contractual right to return of an equivalent number of shares means the investor never fully relinquished their interest in the shares, and the tracking of ownership must therefore 'see through' the loan to allow the investor to retain their enhanced rights once the shares are returned. Tracking of long term ownership, including through the lending process, would require an improved process supported by automated tracking mechanisms that would need to be applied internationally.

No Change of Beneficial Ownership - There are many examples where legal title to securities appears to change hands but where the beneficial owner does not change (e.g. internal movements, account restructure or a change of custodian). In the absence of improved data collection and sophisticated tracking, our members would not have the information to differentiate such a transaction from a regular transfer of ownership. The potential for such changes in legal ownership where there is no change in beneficial ownership would need to be considered carefully in the design of incentive programs.

Additional comments:

- In circumstances where qualification for an incentive becomes due on/around a record date for a dividend/meeting, we see the potential for impacts on the corporate event itself and the ability of an issuer to announce the terms of that event in the first instance and to put in place the necessary funding.
- Corporate event reconciliation will be impacted due to the added complexity of differential entitlements, something which may necessitate the issuance of a temporary stock line as at the qualifying date for ease of administration.
- Current 'market claims' processes rely on a standard rate/entitlement applying to all market participants that are party to a claim. Automated claim processing between shareholders with different entitlements to incentives would be challenging and would require relevant systems to be reviewed and amended to take those incentives into account, the feasibility of which needs to be investigated. Recently agreed harmonisation rules for T2S and market claim processing would be impossible to implement as the buying party / CSD would never know (or be able to prove / disprove) the correct terms to apply to the market claim.

Types of incentive scheme

In the experience of our members, incentive schemes come in two broad categories – enhanced shareholder rights for holders of the same class (voting or dividend), which would require the direct visibility referred to above, and the issuance of 'loyalty/bonus' shares.

'Loyalty/bonus' share arrangements involve the issuance of additional shares to shareholders at some future point in time, subject to certain conditions. Whilst there are historic examples of such schemes in the UK (typically implemented as part of a company privatisation/demutualisation), they are administratively complex and consequently vary rare in recent years. That is not to say that such schemes could not be devised but solutions would be complex as they would have to overcome all the issues described above relating to multiple holding layers.

Conclusion

Effective implementation of a form of shareholder incentive scheme for long term ownership is only possible with the requisite and timely visibility of qualifying shareholders. In our view, it is necessary for the holder to be disclosed to the issuer to allow for the validation of their position and length of ownership, unless strict and effective controls are applied to intermediary claims.

If it is the view of the Commission that there are corporate governance benefits to be derived from the introduction of such incentive schemes, it is essential that work is undertaken to ensure that the operational arrangements and challenges outlined above are tackled effectively. Failure to do so would result in overly complex administrative arrangements or an incentives system that lacks the required integrity. We would be pleased to help with any such work. Whether the governance benefits outweigh the practical challenges associated with delivery, what rates of adoption would be needed to achieve intended outcomes and what any consequential impact on market liquidity might be, need to be studied.

If you have any queries regarding this submission, please don't hesitate to contact me at michael.sansom@computershare.co.uk, or by telephone at +44 870 889 3113.

The Registrars that contributed to this response are Capita Registrars, Computershare Investor Services, Diageo and Equiniti.

Yours faithfully,

Michael Sansom
Chairman