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Exploring the Intermediated
Shareholding Model

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Glossary

Active Investment

An approach to investment where the fund manager selects the assets in the fund. An active investment manager will typically seek to outperform an investment benchmark or performance targets based on levels of return over a period.

Advisory Stockbroking

A service offered by stockbrokers where clients are provided with advice over which shares or other assets their stockbroker should buy and sell on their behalf.

Annual General Meeting (AGM)

A mandatory, public yearly gathering of a publicly traded company's executives, directors and interested shareholders. At an annual general meeting, the Chief Executive Officer (CEO) and director typically speak, and the company presents its annual report, which contains information for shareholders about its performance and strategy. Listed companies are required to seek shareholder approval of the annual report and specific resolutions on issues such as appointments to the company's board of directors, executive remuneration and dividend payments.

Asset Manager

See "Investment Manager".

Beneficial Owner

The individual or entity that enjoys the benefits of owning an asset, regardless of whose name the title of the property or security is in.

Broker

An individual or organisation that acts as an intermediary between a buyer and seller of shares and other securities, usually in return for the payment of a commission.

Central Securities Depository (CSD)

An entity that 1) enables securities transactions to be processed and settled by book entry; 2) provides custodial services (e.g. the administration of corporate actions and redemptions); and 3) plays an active role in ensuring the integrity of securities issues. Securities can be held in a physical (but immobilised) form or in a dematerialised form (whereby they exist only as electronic records).

Contract Based Pension Scheme

These may be work-based or individual pension schemes. In work-based contract-based schemes, the employer appoints a pension provider, usually an insurance company, to administer their pension scheme. The employees enter into a contract directly with the

pension provider, although the employer may make arrangements to collect and pay contributions. In individual contract-based scheme, an individual enters into a contract for provision of a pension directly with a pension provider.

Corporate sponsored nominee

A nominee account operated on behalf of a company allowing individual shareholders of that company to hold shares in uncertificated form without incurring administrative charges and whilst still receiving access to shareholder rights. Such accounts are typically administered either by a registrar company or a broker.

Crossholding

Within the context of this report, crossholding is a research term used to indicate the product holdings of a particular group of individuals in terms of what other products they hold. For example, in a broader financial survey we might look at the crossholdings of those who hold personal current accounts to see what proportion of these consumers also hold mortgages or credit cards. In this report, we look at individual investors who invest in shares in a particular way and look at what other methods they also use. This is in order to illustrate that many hold shares in a variety of different ways.

Custodian

An institution that is responsible for the safekeeping and administration of assets belonging to another. Custodians will often handle administrative arrangements such as collecting coupons and dividends.

Defined benefit (DB) pension schemes

A type of pension where the amount an employee receives on retirement is pre-determined, and is calculated on the basis of the employee's final salary or career average salary and length of service. The amount received on retirement does not depend on the performance of the pension scheme's investments.

Defined contribution (DC) schemes

Also known as "money purchase" schemes. A type of pension where the amount received by a member on retirement will be calculated by reference to the contributions they have made (and often those made by an employer on their behalf) to the scheme and the investment return on those contributions.

Dematerialisation

The issue of securities, such as shares, without any paper certificate to evidence title. Instead, the dematerialised (or uncertificated security) is represented by an entry in an electronic register and its ownership is transferred by amending the register.

Discretionary Stockbroking

A service where the stockbroker buys and sell shares on behalf of a client, and is given full discretion by them over which shares to buy and sell.

Execution only stockbroking

Where decisions over which shares or other financial investments are bought or sold are made by clients without any advice from the stockbroker. The stockbroker's role is to execute their clients' transactions, once they have been decided. Execution only customers are also known as 'self-directed'.

Fund manager

An employee of an investment manager directly responsible for the management of a particular fund.

Immobilisation

Immobilisation entails placing securities in paper form in a central securities depository, such that the depository (or its nominee) becomes the owner of all the securities and all the other investors then hold through that depository.

Institutional Investor

A broad term for organisations that pool large sums of money and invest these in securities, real estate and other investment asset classes. Typical institutional investors include insurance companies, retirement or pension funds, hedge funds, and mutual funds.

Investment consultant

An individual (or organisation) that gives strategic advice on making investments and/or the selection of investment managers.

Investment intermediary

An intermediary in the investment chain. In a typical investment 'chain', this includes investment managers, brokers and custodians.

Investment manager

Also known as a "fund manager" (for example, in the pensions legislation) or "asset manager". An individual (or organisation) to whom the responsibility for the day-to-day management of the scheme's assets is delegated. The investment manager will act on the basis of instructions given to them in the investment mandate.

Investment mandate

The agreement between an investment manager and their client outlining how the assets of the pension scheme are to be managed. The mandate will often contain performance targets and restrictions on which investments the investment manager can make.

ISA (Individual Savings Account)

An ISA is a tax wrapper allowing individuals to hold cash, shares, and unit trusts free of tax on dividends, interest, and capital gains. Where ISAs contain shares in individual companies (rather than funds) selected by an individual investor they tend to be known as 'self-select' ISAs.

Omnibus or Pooled accounts

These are accounts where the assets of several different investors are held together. Where stockbrokers hold client funds in one account this tends to be referred to as a pooled nominee account. Where a custodian holds institutional client funds in one account this tends to be referred to as an omnibus account.

Passive investment

An approach to investment which typically involves tracking the investment performance of a specific market index (e.g. the FTSE 100). A passively managed fund can also be known as an "index fund".

Platform

Also known as an "investment platform". May refer both to a "platform" as a piece of technology or to an intermediary who facilitates the purchase of investments.

Principles for Responsible Investment (PRI) ¹

A United Nations sponsored initiative comprising of an international network of investors working together to put the six Principles for Responsible Investment² into practice. Its goal is to understand the implications of sustainability for investors and support signatories to incorporate these issues into their investment decision making and ownership practices.

Proxy (voting) advisors and analysts

A proxy advisor is a firm hired by shareholders of public companies (in most cases an institutional investor of some type) to recommend and sometimes cast proxy statement votes on its behalf. A proxy analyst provides their customers - typically investors – with analysis of the issues raised by resolutions to be voted on at company general meetings.

¹ <http://www.unpri.org/>

² <http://www.unpri.org/about-pri/the-six-principles/>

Proxy voting agents

Manage the infrastructure for the voting process on behalf of custodians or investors.

Registrar

A company which manages the register of shareholders on behalf of an issuer, responsible for day to day communication with shareholders over matters relating to the management of their shareholdings – change of address, dividend payment, transmission of shares etc. – and also manages the general meeting voting process on behalf of an issuer.

Shareholder engagement

An approach to investment which emphasises the importance of effective dialogue between investors and investee companies. Engagement may involve an exchange of views on issues such as strategy, performance, board membership and quality of management.

Shareholder rights

The rights due to the shareholder whose name appears on the register as the owner of the shares. These can be:

- Information rights: The right to receive information about the company's performance, strategy and decision making direct from the company (e.g. a copy of the annual report).
- Voting rights: The right to vote at AGMs, EGMs or on other matters either in person or by proxy.

Share ownership – definition from the Kay Review³

The term “share ownership” is often used, but the word “ownership” must be used with care. It is necessary to distinguish:

- *Whose name is on the share register? (often a nominee)*
- *For whose benefit are the shares held? (e.g. a pension fund trustee)*
- *Who makes the decision to buy or hold a particular stock? (normally an asset manager)*

³ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/253454/bis-12-917-kay-review-of-equity-markets-final-report.pdf

- *Who effectively determines how the votes associated with a shareholding should be cast? (this might be an investment manager, a pension fund trustee, or a specialist proxy voting service);*
- *Who holds the economic interest in the security? (i.e. who is the saver who bears the gains and losses from investment?)*

SIPP (Self Invested Personal Pension)

A pension plan that enables the holder to choose and manage the investments made themselves.

Segregated or Designated accounts

These are accounts which only hold the assets of a particular investor. Where stockbrokers hold client funds in their own individual account this tends to be referred to as a designated nominee account. Where a custodian holds an institutional client's funds in its own individual account this tends to be referred to as a segregated account.

Stewardship

A practice which aims to promote the long term success of companies in such a way that protects and enhances the value that accrues to the ultimate beneficiary of an investment. Stewardship activities include monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure, and corporate governance, including culture and executive remuneration.

Stock lending

The temporary transfer of shares by a lender to a borrower, with agreement by the borrower, to return equivalent shares to the lender at a pre-agreed time. The borrower will give the lender collateral as security and will pay lending fees.

Stockbroker

An organisation that buys, sells and holds individual shares and other assets on behalf of private clients.

Straight through processing (STP)

An initiative used by companies in the financial world to optimize the speed at which transactions are processed. This is performed by allowing information that has been electronically entered to be transferred from one party to another in the settlement process without manually re-entering the same pieces of information repeatedly over the entire sequence of events.

Transaction costs

The variable costs associated with buying, holding and selling the underlying investment instrument. Examples of transactions costs include brokers' commissions, bid-offer spreads and transaction taxes.

Trust-based pension scheme

A pension scheme that is established using a trust. The trustees are responsible for managing the scheme and for reviewing and monitoring investments.

Executive summary

Introduction and methodology

Relationships between companies and investors consist of long chains of intermediaries. Individuals often hold shares indirectly in a nominee account under the name of a broker at a custodian bank. Institutions invest via an ownership chain including investment advisers, investment managers, custodian banks, central securities' depositories and registrars. The voting process for institutional investors is delivered via a separate chain built around this and it involves other intermediaries such as proxy voting agents and proxy voting advisers.

The Government wants to encourage better and greater shareholder engagement with companies in order to facilitate good corporate governance. The Kay Review into UK Equity Markets suggested that there was the potential for elements of intermediation to work less effectively than they should.

This research was commissioned by BIS to provide an independent review of the chains of ownership and voting between individual or institutional investors and the companies they invest in, and to identify any weak links in these chains.

The research sought to find out:

1. The reasons why individual investors held shares in a particular way
2. Whether individual investors were aware of alternative methods of holding
3. How investor voting procedures worked in practice
4. Whether investors understood the extent to which they could exercise the rights associated with their shares
5. The fees associated with each element of the model and the investor's perception of the value added
6. The extent to which investors understood what they received for the fees they paid

At an early stage, it was decided that it made sense to look at the issues for individual investors and institutional investors separately. This research provides an independent review of the chains of ownership and voting which have developed between the companies and the individual and institutional investors which hold shares in them and to identify any weak links in these chains. The research focussed on gathering evidence of: 1) the workings of the investment and voting chains (particularly on the institutional investment side), and 2) the perceived value of elements of the holding chain.

Research findings are based on surveys conducted with individual investors, interviews with intermediaries and representative industry bodies and desk research. The main investor survey was conducted amongst a representative sample of UK adults, and therefore the authors can be confident that the data expresses a representative view. The discussion with intermediaries and other representatives were qualitative in nature. Here the report reflects the thoughts and opinions of those with whom we spoke.

Key Findings

Individual investors (p28 – 89)

Amongst the general population of individual equity investors, our research indicated that the population was evenly split between those who only hold paper shares and those who had also invested in shares held in electronic format via a range of different methods and brokers. The overall picture was complicated in terms of which shareholder rights were available for each investment.

Around half of equity investors held certificated (or ‘paper’) shares, and therefore currently have automatic access to information and voting rights for these holdings.

The other half of equity investors held shares in uncertificated form. These investors typically used brokers who were much more likely to offer pooled nominee accounts rather than designated nominee accounts or personal CREST membership and so those who used a broker (around four in ten from the Omnibus survey) did not typically receive shareholder rights automatically.

Brokers generally expressed a willingness to pass back such rights (and would be unlikely to charge specifically for this) but did not pass back rights proactively.

Brokers argued that pooled nominee accounts are cost effective and enable them to keep costs down for clients. They also saw themselves as “protecting” their clients from unwanted information from the companies in which they hold shares, although there was no mention of this from investors themselves.

The brokers did not perceive that their clients had any issues with pooled nominee accounts, and they saw little appetite for voting or attending Annual General Meetings (AGMs) while much of the company information can be found online.

The view from the individual investors supported this to some extent in that there were few complaints about associated administration costs and most had the level of engagement with companies that suited them.

The costs of “custody and administration” involved in nominee accounts were often passed on by brokers to customers in the form of an annual charge or monthly account management charge based on a percentage of the value of the portfolio. There was a wide range of fees for “execution only” servicing (where decisions over which shares or other financial investments are bought or sold are made by clients without any advice from the stockbroker) with some of the larger portals making no charge and some of the stockbrokers charging a fixed percentage charge (up to 0.02% of total value), but often capped at a particular figure (e.g. £100 maximum charge). Individual investors tended to be more focussed on transaction charges (often stated in cash terms rather than a percentage) and accepted custody and administration charges as a ‘relationship cost’.

In general, individual investors tended not to factor in the degree to which they were engaged or distanced from companies when deciding which brokers or methods of holding to use. The exception was amongst more engaged investors, some of whom chose to hold

via personal CREST accounts. Amongst less engaged investors awareness of different holding methods and the consequences with regards to shareholder rights was low.

The majority of individual investors (76%) had low interest in voting or attending AGMs, although there were equity investors holding shares via all methods who valued their shareholder rights. There were many examples of share prices being followed; company documents read, and a general feeling that these rights were important in principle (even if rarely exercised). Amongst individual investors, any loss of rights would be felt.

Amongst those who had voted (52%), the principle of being able to vote is as important as the outcome. It makes investors feel involved as a genuine stakeholder in the companies in which they have invested.

Many equity investors were unsure as to the nature of their shareholding and what this meant for any shareholder rights. This was a complicating factor as some equity investors “didn’t know what they didn’t know”, particularly if brokers did not mention it unless asked. However, there was a general feeling among investors that the shares were “theirs”.

However, the survey research suggested that when made aware of the impact of a pooled nominee account on shareholder rights, most of those who were previously unaware (86%) did not plan to ask their broker to pass back their rights to them.

Those who belonged to shareholder representative organisations such as the Shareholders Society (ShareSoc) and UK Shareholders Association (UKSA) were different, attitudinally, to equity investors more generally. For members of these associations, shareholder rights were an important issue and they wished to see them provided to underlying investors where they were not currently available.

More engaged individual investors frequently described their investment as a hobby, suggesting that they did not expect the time spent in researching companies and engaging with them to be compensated by returns. They nevertheless invested with a view to creating return in the medium to long term. In addition to medium to long term portfolios, some also kept short term trading portfolios.

Therefore the general picture here is one of a range of holding options being available and, whilst there is some information shortfall in some circumstances, individual investors being content with the costs, value added services and voting rights they experience from the investor chain. Also individual investors are broadly content that their preferred degree of engagement is accommodated within the holding methods available.

Institutional Investors (p90 – 136)

Institutional investors did not own or control shareholder rights, rather these were systematically distributed between different intermediaries in the chain; for the most part custodian banks and investment managers.

Views from contacted academics and intermediaries (p116 – 117)

In this report we spoke to two academic sources⁴ and a number of intermediaries.

They indicated that they felt that the investment chain was not truly dematerialised, rather it existed as a digital synthesis of a series of analogue (paper based) processes. They also felt that the structure of the investment chain had stimulated an increase in intermediation which in turn has distanced investors from share issuers; and the current structures were convenient for intermediaries, but inconvenient, difficult and more costly than they needed to be for share issuers and investors.

Furthermore, the intermediated shareholding model created opacity and lack of granularity in both company registers and the register at Central Securities Depository (CSD) level (i.e. in CREST):

- Whilst investor transparency was enshrined under company law⁵ the registers only provided detail of the registered shareholder, not the underlying investor. Investors therefore needed to find alternative means of confirming (to a share issuer) their status as an investor and also of finding other investors to combine with for engagement and voting purposes.

Also there were few structural barriers preventing larger pension funds and other underlying investors from gaining access to and exercising their shareholder rights. However, the barriers that existed for smaller funds were considerable:

- Not all investment managers were prepared to facilitate proportional voting for pooled funds, and many dissuaded smaller funds from exercising “voice” in this way.
- This was exacerbated by omnibus pooling at the level of the custodian, which may have presented an additional barrier for an investment manager even where the will to offer proportional voting existed.

Finally, in order to circumvent these barriers, a number of mechanisms for collective engagement and voting were either currently available or under development at the time of the research. The investment chain placed voting rights by default in the hands a nominee company managed by a custodian which was in turn instructed by the institutional investor

⁴ Dr. Eva Micheler, Reader in Law at LSE and a Universitäts professor at the University of Economics in Vienna and Professor David C Donald of the Chinese University of Hong Kong. Both have published on the subject of securities law and spoke to the authors about their work.

⁵ Under section 793 of the Companies Act 2006, a public company may give notice under this section to any person whom the company knows or has reasonable cause to believe:

(a) to be interested in the company's shares, or

(b) to have been so interested at any time during the three years immediately preceding the date on which the notice is issued.

that had a direct relationship with the custodian; sometimes a larger pension fund or sovereign wealth fund, but more often an investment manager.

If, as in many instances, there was no specific agreement between the investor and the investment manager to instruct voting, or where no such instructions were provided, the investment manager was in a position to vote as it saw fit.

Views of contacted investors and investment managers (p114-136)

The interests and opinions of underlying investors and investment managers we spoke to were somewhat different.

- Intermediaries speculated that there could be a material difference in voting outcomes if underlying investors were to become more active participants in voting, particularly around issues of remuneration where the objectives and opinions of investment managers differed somewhat to those of investors.
 - The voting chain was a workaround solution designed to cope with the curious nature of the investment chain. It was opaque and of questionable accuracy:
 - The record date for voting and the record date for the meeting occurred on the same date, which some participants felt mitigated against accuracy of voting.
 - Opacity of ownership made collective action, such as shareholder resolutions, more difficult.
- There were currently low incentives for intermediaries to improve the accuracy of voting or to deliver vote confirmation.
- It was far from straightforward for an institutional investor to have any certainty that its votes had been cast in a meeting. There is a change of CREST status which confirms receipt of data, but these messages only allow for very limited granularity. The lack of vote confirmation was considered by the majority of intermediaries with whom we spoke to be a significant deficiency in the current voting chain.
- There appeared to be a smaller number of beneficial owners and investment managers who were passionate about stewardship, engagement and voting, but a larger number of less engaged participants who 'ticked the box'.
- There was market concentration in the proxy voting advice industry, and this may have contributed to 'herd voting' amongst less engaged participants who were content to follow all voting recommendations.
- Fee structures in the institutional investment chain were not clear cut. There was bundling and opacity in relation to (for example) investment management. Some fee structures such as performance fees charged by investment managers to a pension fund were impenetrably complex.

- Some funds openly questioned the extent to which custody fees, which were mandatory within the current structures and charged on a percentage basis, were justified. It was felt that custody does not add value and is somewhat anachronistic under dematerialisation.

Thus overall there appeared to be opacity around voting and voting rights and fees in the investor chain. However many institutional investors were happy to be less engaged.

Considering 'investors' and 'brokers' at an overall level

Whilst individuals and institutions were very different in terms of scale, there were parallels between how the chains function and the effects on participants:

- In both investor communities, there were relatively large numbers of investors, who had low interest in exercising shareholder rights;
- In both communities there were smaller numbers of highly engaged investors who felt very strongly about shareholder rights and their ability to exercise them;
- Institutional investors and some individual investors were subject to pooling of their assets with other investors and had very little control over how this was done;
- Individual and institutional investors had to expend effort in order to obtain access to and exercise shareholder rights;
- In both communities there were those who felt that they were excluded from accessing and exercising shareholder rights;
- In both communities, there were brokers (or investment managers) who perceived that the roles of asset management and stewardship were intertwined; and
- In both communities, investors had become systemically distanced from the companies they invested in over time.

Both the Kay Review and the Law Commission have questioned whether the level of intermediation involved in investing in shares in the UK is appropriate. Amongst the participants we interviewed, opinions were mixed: some felt that there was excessive intermediation and other felt that the current situation provided convenience and stability.

Introduction

The Government wants to encourage better and greater shareholder engagement with companies in order to facilitate good corporate governance.

As the Kay Review into UK Equity Markets⁶ and Long Term Decision Making and the Law Commission Review of Fiduciary Duties⁷ both acknowledge, relationships between companies and many of their investors are highly intermediated. Both suggest that there is the potential for elements of intermediation to work less effectively than they should.

Few shareholders now hold shares directly from a company: they are now usually held indirectly, often through a chain of intermediaries.

Individual investors either hold shares directly in their own name (where holdings are certificated) or indirectly, often in a nominee account of a broker at a custodian bank.

Institutions invest via an ownership chain of intermediaries including investment advisers, investment managers, and custodian banks. The voting process for institutional investors is delivered via a separate chain built around the ownership chain and this further consists of proxy voting agents and proxy voting advisers.

Investor representative bodies suggest anecdotally that underlying investors (individual and institutional) can find it difficult to be permitted to access information and exercise voting rights (which can be passed to them by brokers and asset managers but in the view of representative bodies, often aren't).

This research report aims to provide an independent review of the chains of ownership and voting which have developed over time, but more particularly in the recent past between individual and institutional investors and the companies they invest in and to identify any weak links in these chains.

Our research findings are based on primary survey data with individual investors, interviews with participants (intermediaries) in the chains between investors and companies, institutional investors, company representatives and desk research in order to supplement information gaps.

⁶ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/253454/bis-12-917-kay-review-of-equity-markets-final-report.pdf

⁷ http://www.lawcom.gov.uk/wp-content/uploads/2015/03/lc350_fiduciary_duties.pdf

Objectives

The research aimed to look at the cost of the chains for investment and voting and to explore the value added by each link set against the costs incurred and the extent to which investors were aware of what their fees covered. Additionally, the research examined the levels of investor engagement with companies and the extent to which they are, or could be enfranchised.

The research explored the extent to which individual investors wished to engage with companies and why they held their shares in a particular way; on paper, via a personal CREST account, in a pooled nominee account or a designated nominee account. Were they aware of the alternatives available?

The research also investigated why investors had chosen different levels of servicing; (i.e. execution only, advisory and discretionary). What value did they receive and how, if at all, did this affect their level of engagement with the companies they had invested in? Did their brokers pass back shareholder rights, whether automatically, or on request and if so, did they make use of these rights? Where brokers did not pass back shareholder rights what was the perceived impact of this? To what extent was the loss of rights felt?

The research was to provide an overview of the UK market which illustrated the range of different offerings from brokers and share trading portals with regards to holding shares.

The themes for institutional investors were somewhat similar. To what extent did institutional investors wish to engage with companies? Why did they hold shares in particular ways; for example why might shares be held at the level of the investment manager in pooled funds rather than via a custodian of their own choosing?

Were intermediated chains for investment and voting working efficiently and in the interests of investors and share issuers? If not, why not? What impact did pooling at the level of the custodian in omnibus accounts have on the function of these chains?

For institutional investors the research sought to explore the fees paid versus the value added by each link in the investment chain and the voting chain. To what extent were these transparent, and what level of competition was there in the market for these intermediated services? Were the incentives of the intermediaries sufficiently aligned with their own as investors?

Methodology in Brief

The following section provides a brief description of the methodology used in order to conduct the research. A more detailed methodology can be found in Appendix 1.

The aim of the study was to provide a better understanding of the shareholding model and how it functions for both individual and institutional investors.

Whilst there are parallels and common issues for individual and institutional investors, their 'worlds' are somewhat different. Consequently we decided to look at the issues for each group separately:

The individual investor chain

We conducted:

- A consumer survey using a representative sample of 1,000 adults, in order to provide an overview of ownership.
- A qualitative telephone survey of 100 individual investors using different approaches in order to invest in shares.
- Eight in-depth face to face interviews with those felt to represent these different investor segments well, in order to provide more detail.
- Eight in-depth interviews (mainly face-to-face, some via telephone) with stockbrokers and others offering share-trading services to individuals via a range of different business models.
- Desk research and some follow up calls in order to build an overview of the broker market in the UK with regards to types of account offered and access to shareholder rights provided.

The institutional investor chain

We conducted in-depth face-to-face and telephone interviews⁸ with organisations involved in the chain, including:

- Institutional investors – pension funds, insurance funds, charitable investors.
- Share issuers and their representative bodies.

⁸ In order to make best use of resources, the researchers arranged personal meetings wherever possible, but used telephone interviewing where respondents were in remote locations or had limited availability

- Other participants in the chain:
 - Registrars, Euroclear (CREST), investment managers, investment advisers, Investment consultants, proxy voting advisers, proxy voting agents , custodians.

In addition, we spoke with academics and legal experts who have researched the mechanics and legal aspects of share ownership in the UK and other markets and who have published reports on this subject.

Reporting on the institutional investor chain is based on the opinions of a relatively small sample of participants in the investment chain. Whilst all were very senior and highly experienced professionals, there can be no certainty that their views are representative of the entire intermediary community.

Share ownership: A short historical perspective

In order to understand 'how we got to where we are', we feel that it is useful to provide, briefly, an overview of the history of share ownership.

Shares in companies have been traded in the UK for hundreds of years and the practice of the share issuing company keeping a written record of its share owners was established from the outset. Very early on it was found useful to issue certificates representing the value of such investments that could be traded between investors. In order to remove the potential for forgery and fraud, it was essential that registers were constantly updated with the names of new investors and that this 'name on register' acted as proof of ownership (rather than any individual documents).

In the mid-20th century the volume of trade in shares (and other financial instruments) increased to the point where it was no longer feasible to trade paper documents. This was leading to failure amongst brokers in some markets who were trading (buying and selling) faster than they were able to settle these trades (complete the paperwork necessary to issue the buyer with new certificates).

As a consequence of these problems in coping with large volumes of paper, two internationally recognised mechanisms were developed by which a computerised / digital system could be used to replace paper: immobilisation and dematerialisation:

- Immobilisation entails placing securities in paper form in a central depository, such that the depository (or its nominee) becomes the owner of all the securities and all other investors then hold through that depository.
- Dematerialisation means that companies can issue shares without any paper certificate to evidence them. Instead, the dematerialised security (or uncertificated security) is represented by an entry in an electronic register and is transferred by amending the register.

In certain countries, e.g. the USA, immobilisation was only ever intended to be an interim measure. In the 1970's it was felt after much debate that the technology available at the time was not ready to support a fully dematerialised model able to retain and manage direct links between share issuers and investors.

In countries such as the USA where an immobilised model exists, the Central Securities Depository (CSD) is the first holder in a chain. It holds on behalf of account holders, who may be banks, corporations or foreign CSD's. These account holders may in turn hold some or all of their securities on behalf of their own customers, who in turn hold on behalf of their customers. This creates long chains of intermediaries between the issuing company and the end investor and only the CSD retains a direct relationship with the share issuer.

- In order for a share issuer to contact its shareholders at any point in time (for example, for voting purposes), it needs to send instructions via the CSD and along the chain of intermediaries using a complex, 'back and forth' messaging infrastructure.

The USA tends to prioritise confidentiality and privacy, therefore the restrictions on visibility and transparency created by immobilisation are viewed as acceptable by regulators and most, but not all, market participants. Other markets in Scandinavia and Eastern Europe for example have evolved highly transparent models which regulate in favour of full visibility of investors on company registers.

The UK model for dematerialised shareholding has evolved somewhat differently to other markets. CREST is the main securities settlement system, but CREST has no ownership rights over UK issued securities. It does not hold shares from issuers on behalf of investors. Instead, it operates a register which confers legal title on the person or entity named in the register. Each member on the CREST register is treated as the shareholder under company law and is entitled to exercise voting and other rights directly from the share issuer.

The names appearing in the CREST register are normally those of nominee accounts operated by custodian banks rather than the names of investors. In this sense, there is no overall transparency around share ownership. However, share issuers do have the right under company law to trace beneficial owners via a disclosure process and to enforce disclosure and penalties for non-disclosure. Therefore there are underlying principles of transparency within the UK model.

The introduction of CREST in the late 1990's did not fully dematerialise shares. Individual investors could still opt to hold shares certificated (paper) form if they so wished. An option was also created for individual investors to hold directly in CREST via a sponsoring broker.

So, for individual investors, the introduction of CREST meant that shareholdings held via a stockbroker were normally held in dematerialised form either in:

- A pooled nominee account (in the name of the broker and together with the other clients of the same broker)
 - *All individual shares held in SIPPs and ISAs are held in nominee accounts. This is not the only solution permitted in law, but the only one used in practice.*
- A segregated nominee account (in the name of the broker, but separate from other shareholders).
- A CREST personal account (in the name of the investor, but operated by the broker).

For these customers, the 'name on the register' (with the exception of the CREST sponsored accounts) became the name of the nominee of the broker. For example: *XYZ Nominees Limited*.

Those continuing to hold shares via paper share certificates were unaffected. Their names remained on the share register and they kept a direct contact with the companies in which they had invested. Their information rights (receiving annual reports and other documents) and voting rights were therefore retained in full.

Looking towards the future, the EU has published the Central Securities Depositories Regulation (CSDR)⁹. CSDR sets deadlines of 2023 for ceasing the issue in paper form of most new publicly traded securities and 2025 for the dematerialisation of existing paper shares for publicly traded securities. This will impact on individual shareholders, many of whom hold their shares directly through paper share certificates. An alternative way of holding shares – through electronic means – will need to be found to implement dematerialisation.

⁹

http://ec.europa.eu/finance/financial-markets/central_securities_depositories/index_en.htm

Findings

The Individual Investor Chain

This section of the report covers the views of individual investors, that is consumers who invest in publicly traded companies either by holding paper share certificates, or via a dealing or other account with a broker, including as part of a self-invested pension plan (also known as a SIPP) or in a Stocks and Shares ISA (individual savings account).

The data reported here were gathered from:

- A consumer survey with a representative audience of the general public
- 400 additional interviews with ShareSoc/UKSA members.
- 100 follow-up qualitative telephone interviews to explore certain aspects of equity investment in more detail.
- A small number of face-to-face interviews to provide case study examples of equity investment behaviour.

Consumer survey

Questions were placed on a **Consumer Omnibus survey**. This type of study interviews a representative sample of UK adults about a variety of topics, of which these shareholding questions formed one section. The telephone interviews were conducted by a third party agency and potential respondents were selected at random, then screened to ensure they met the relevant quotas by age, gender, social grade, region etc. The overall results were then weighted by age, gender, region and a measure of socio-economic status and grossed up to be representative of the UK adult population as a whole.

Using a Consumer survey of this nature provides a view on the overall size and profile of the market of UK individual equity investors, accepting that this is a sample of all adults and not a census and thus a margin of error will apply around the results.

One thousand and one adults were part of the initial survey. In order to complete the remainder of the survey (our questions on share ownership), these respondents had to agree with one or more of the following:

- They own shares in a publicly traded UK based company
- They hold individual company shares in a self-invested pension plan (SIPP)
- They hold individual company shares in a Stocks and Shares ISA

Two hundred and twenty-one of the 1,001 adults interviewed agreed with one or more of these statements and were eligible for the remaining questions. Once the population

weighting and grossing up factors were applied, this was the equivalent of 20% of all UK adults, and an estimated 12 million individual equity investors. This estimate is supported by figures given to the researchers by Registrars¹⁰ which estimated that there are 12-13 million individual investors.

The individual equity investors identified on the Consumer survey qualified as follows:

- 13% of all surveyed adults owned shares in a publically traded UK based company
- 5% of all surveyed adults held individual company shares in a self-invested pension plan (SIPP)
- 11% of all surveyed adults held individual company shares in a Stocks and Shares ISA

Results from this survey are referred to as “Survey identified equity investors” in the analysis below. When reviewing these results, note should be taken of the base size of individuals, which for some questions is below 100 and should therefore be treated as indicative.

Online survey of shareholder interest group members

A second, similar, survey was conducted, this time online, amongst members of ShareSoc and UKSA (The UK Shareholders Association). These are member owned, not for profit organisations for retail shareholders, both of which are active in the area of promoting shareholder rights for their members.

Four hundred surveys were completed amongst members of these organisations. Their views should not be seen as necessarily representative of all equity investors as those who become a member of ShareSoc or UKSA are likely to be more actively involved and knowledgeable about issues relating to shareholder rights, and may have particular views on the issues covered by the survey. The views they expressed should therefore be seen as representing perhaps the more experienced and involved equity investor and thus provide an interesting point of comparison to the more general population of equity investors identified through the survey. With around 4,000 members between them, it is estimated that less than 1% of all equity investors belong to one of these organisations, and their views should be seen in that context.

Four hundred ShareSoc and UKSA members were eligible for the full survey and they qualified as follows:

- 100% owned shares in a publically traded UK based company
- 40% held individual company shares in a self-invested pension plan (SIPP)
- 85% held individual company shares in a Stocks and Shares ISA

¹⁰ Estimates provided by Capita, Computershare and Equiniti, collectively these Registrars administer 99% of the shareholdings on register in the UK

As might be expected, given the source of this sample, levels of shareholding were much higher amongst this audience. Respondents were twice as likely to hold shares in a Stocks and Shares ISA as in a SIPP (this is though the same ratio as for the survey identified equity investors, albeit at a higher level).

Results from this element of the research are referred to as “ShareSoc/UKSA Equity Investors” in the analysis below.

Key quantitative findings

Equity investor demographics

ShareSoc/UKSA equity investors had a clearly defined demographic profile:

- 96% were men
- 76% were aged 55+
- 56% of them had a household income in excess of £48,000

By contrast there was a more even age and gender split amongst survey identified equity investors:

- 58% were men
- 48% aged 55+ (38% were aged 35-55 and 14% were under 35, compared to 21% and 3% of ShareSoc/UKSA equity investors respectively).
- 24% had a household income of more than £48,000

Shareholdings

Shares can be acquired through a variety of means. Table 1 shows the range of sources of shares held by both groups, with respondents mentioning as many sources of shares as were relevant to them. There were some clear differences between the two groups.

As Table 1 shows, amongst survey identified equity investors, there was a fairly even split between the various ways in which shares could have been acquired. One in three (37%) had bought based on professional advice and a similar proportion (32%) had decided themselves to buy shares in a particular company. Around a quarter (28%) took shares offered following a de-mutualisation and a similar proportion (26%) had shares through a workplace Share-save scheme.

By way of contrast almost all ShareSoc/UKSA equity investors (95%) said that they had decided to buy shares in a particular company. They were much less likely to say that they bought on advice from a broker (16%) and twice as likely as Omnibus identified equity investors to have bought shares when a publically owned company was floated (37%).

Table 1: How shares are acquired

How shares acquired	Survey identified equity investors	ShareSoc/UKSA equity investors
<i>Unweighted base</i>	221	400
Bought on professional advice, e.g. broker	37%	16%
Respondent decided to buy shares in particular company	32%	95%
Offered shares as customer of demutualised organisation (e.g. Halifax)	28%	26%
Bought/was given shares through workplace share-save scheme	26%	16%
Shares bought when publically owned company floated (e.g. BT)	18%	37%
Inherited / was given shares by someone	14%	19%

Proportions will not sum to 100% because investors can hold shares by more than one method

Shares are held in a range of formats, with equity investors typically holding them in one to two formats:

Table 2: How shares are held

How shares held – all mentions	Survey identified equity investors	ShareSoc/UKSA equity investors
Unweighted base	221	400
Paper share certificates	53%	45%
Shares are held for you by a broker	38%	71%
A personal CREST account	14%	17%
Held by the company that issued them	41%	24%

- Half of survey identified equity investors (53%) reported that they held paper share certificates and they were as likely to hold shares in this way as ShareSoc/UKSA equity investors (45%)
- ShareSoc/UKSA equity investors were much more likely to have shares held by a broker (71%)
- Survey identified equity investors were almost twice as likely to have shares held by the company that issued them (41%) as ShareSoc/UKSA equity investors (24%)
- A smaller, but similar, proportion of each group of equity investors reported that they had a CREST personal account (14% of survey identified, 17% of ShareSoc/UKSA).

Table 3 shows the proportion of equity investors in each group who only held shares by just one method of shareholding. A quarter of all survey identified equity investors only held paper shares, compared to one in ten ShareSoc/UKSA equity investors:

Table 3: Shares held using one method of holding only

Shares held ONLY in this way	Survey identified equity investors	ShareSoc/UKSA equity investors
Unweighted base	221	400
Hold in one method of holding	66%	54%
Paper share certificates	27%	10%
Shares are held for you by a broker	19%	34%
A personal CREST account	3%	4%
Held by the company that issued them	16%	6%
Hold shares in more than one format	34%	46%

- 19% of survey identified equity investors only held shares with a broker. This was more common amongst ShareSoc/UKSA equity investors (34%)
- A third of survey identified equity investors (34%) held shares in two or more ways compared to almost half of ShareSoc/UKSA equity investors (46%). This means that they potentially have differing access to shareholder rights across their portfolio.

Cross holding amongst retail shareholder

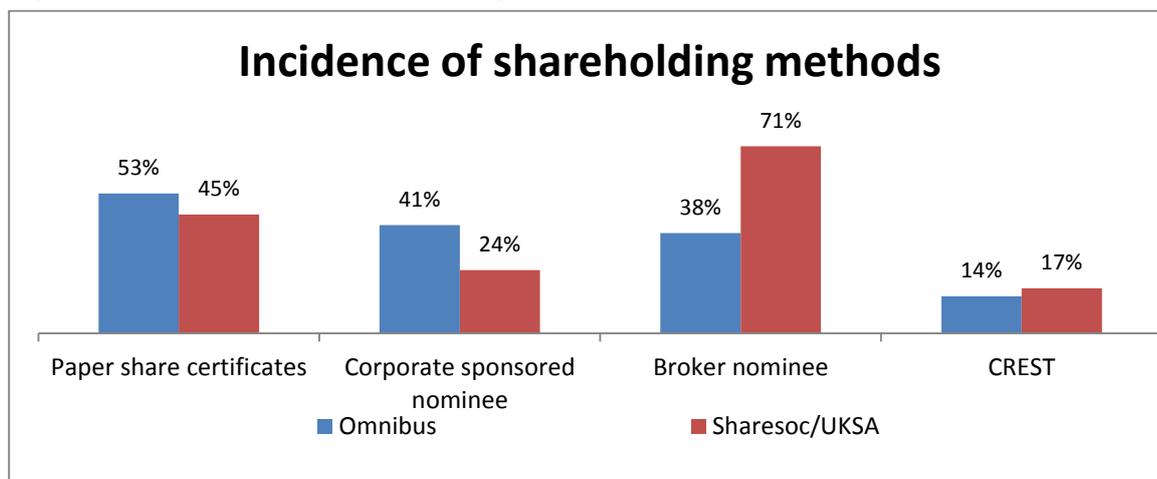
It became apparent during this analysis that retail shareholders cannot be neatly segmented into batches of consumers who hold shares in a single format. The situation is further complicated by the level of consumer knowledge and understanding which is relatively poor for many investors, certainly concerning ways of holding shares.

Initially we sought to create ‘silos’ of investors that shared certain characteristics. Whilst this was successful up to a point, it is important to remember that many individuals appeared to have a range of ways in which they held shares and that their circumstances could change. For example, an investor that once favoured share purchase from a self-directed trading portal might become time poor and prefer to hand over management to a discretionary wealth manager. Similarly, an individual investor, who used to buy shares in certificated form, may now find it cheaper and more convenient to purchase electronically via an online broker.

This analysis is an extension of the initial data reported above on the extent to which individual equity investors use more than one form of shareholding.

Figure 1 presents the initial data, showing the range of forms of shareholding used by both survey identified equity investors and those from ShareSoc/UKSA:

Figure 1: Incidence of shareholding methods



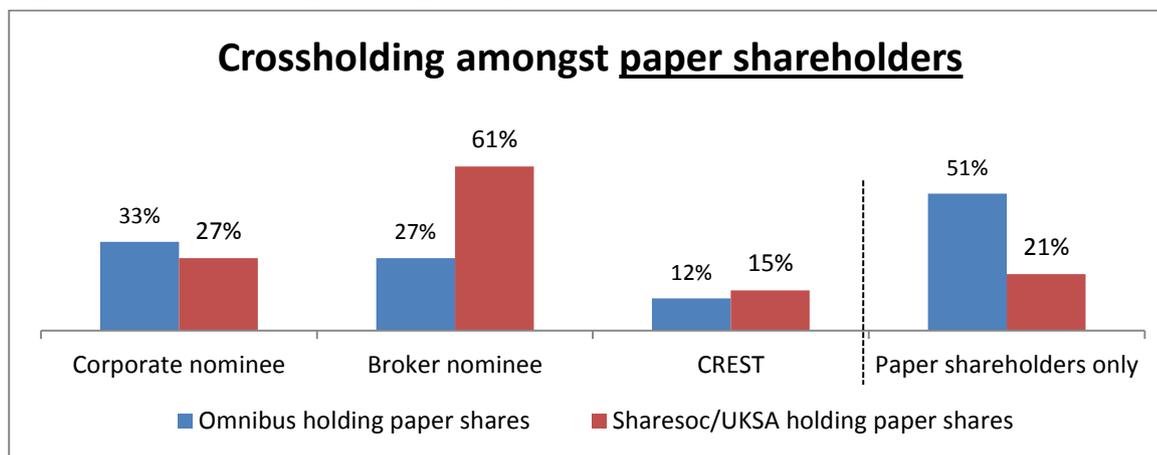
Unweighted base: All shareholders – 221, Those in shareholder associations - 400

The remainder of charts in this section look at each form of shareholding in turn and the extent to which those using a particular form of shareholding also used other forms of shareholding as well.

Paper shares were held by half of all survey identified equity investors (53%) and a similar proportion of ShareSoc/UKSA equity investors (45%).

As Figure 2 shows, half of these survey identified equity investors with paper shares said that this was the only way in which they held shares (51%), compared to one in five (21%) of ShareSoc/UKSA equity investors with paper shares. Amongst ShareSoc/UKSA equity investors who held paper shares, over half (61%) also held shares in a broker nominee account:

Figure 2: Crossholding amongst paper shareholders

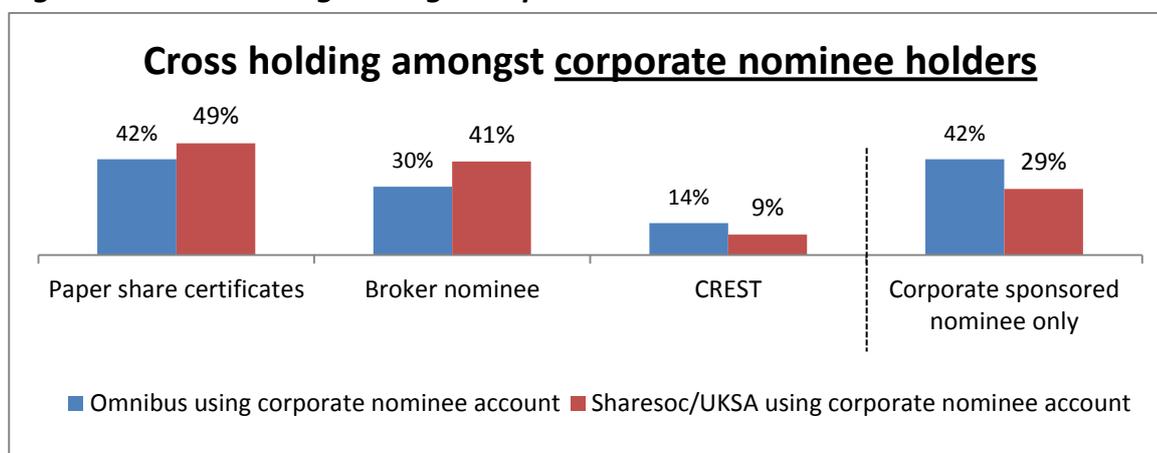


Unweighted base: All shareholders with paper share certificates – 114, those in shareholder associations - 181

Corporate nominee accounts were used by four in ten of all survey identified equity investors (41%) and a quarter (24%) of ShareSoc/UKSA equity investors.

As Figure 3 shows, four in ten of these survey identified equity investors with a corporate nominee account said that this was the only way in which they held shares, compared to one in three (29%) of ShareSoc/UKSA equity investors with a corporate nominee account. Around four in ten of both the survey identified equity investors with a corporate nominee account (42%) and the ShareSoc/UKSA equity investors with a corporate nominee account (49%), also held paper shares:

Figure 3: Cross holding amongst corporate nominee holders

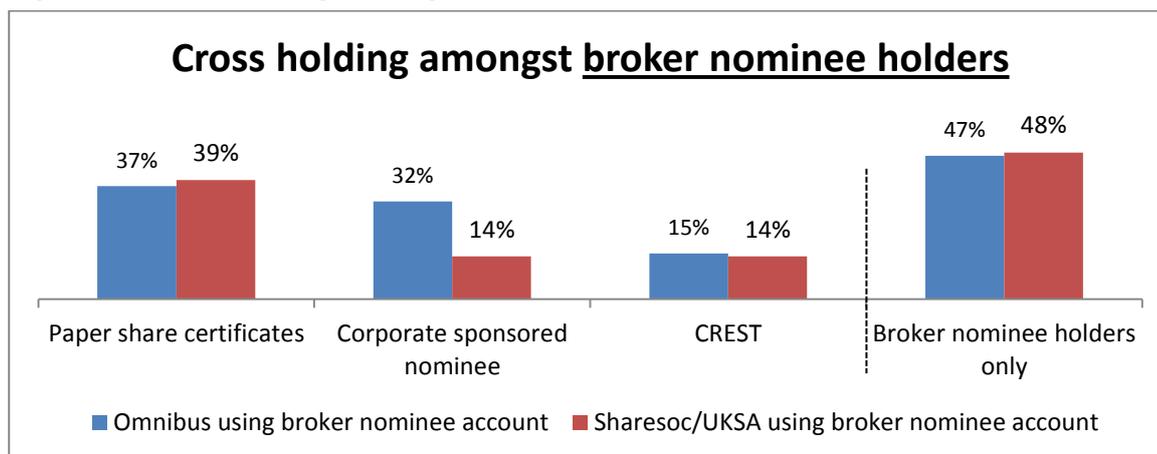


Unweighted base: All shareholders with shares in corporate nominees – 93, those in shareholder associations - 97

Broker nominee accounts were used by four in ten of all survey identified equity investors (38%) and seven in ten (71%) of ShareSoc/UKSA equity investors.

Nearly five in ten of these survey identified equity investors with a broker nominee account said that this was the only way in which they held shares (47%), and this was also the case for ShareSoc/UKSA equity investors with a broker nominee account (48%). Around four in ten of both the survey identified equity investors with a broker nominee account (37%) and the ShareSoc/UKSA equity investors with a broker nominee account (39%), also held paper shares:

Figure 4: Cross holding amongst broker nominee holders

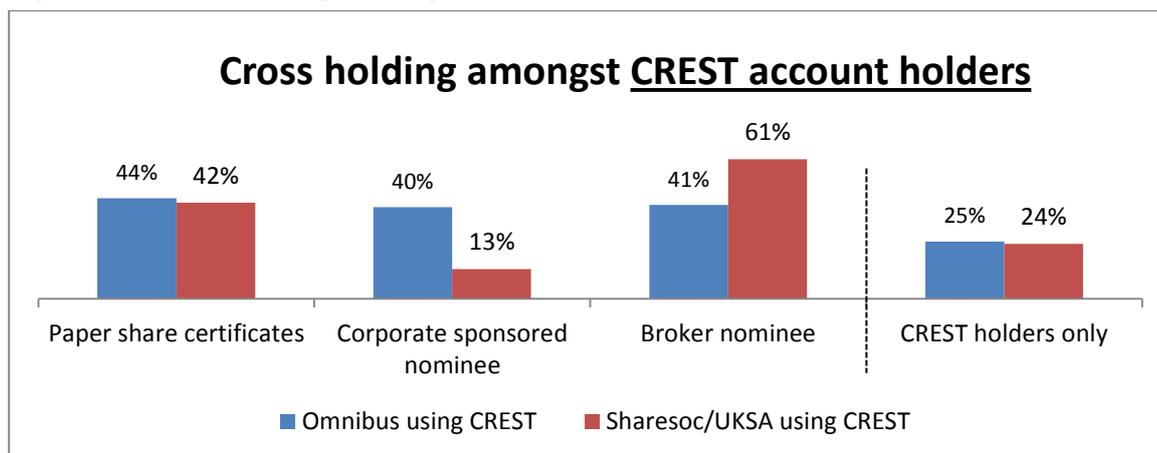


Unweighted base: All shareholders with shares in broker nominees – 88, those in shareholder associations – 283

CREST accounts were used by just over one in ten of all survey identified equity investors (14%) and almost one in five of ShareSoc/UKSA equity investors (17%).

A quarter of these survey identified equity investors with a CREST account said that this was the only way in which they held shares (25%), and this was also the case for ShareSoc/UKSA equity investors with a CREST account (24%). Around four in ten of the survey identified equity investors with a CREST account (41%) and six in ten ShareSoc/UKSA equity investors with a CREST account (61%), also held shares in a broker nominee account:

Figure 5: Cross holding amongst CREST account holders



Unweighted base: All shareholders with shares in CREST – 33, those in shareholder associations - 67

When talking in more detail to individual equity investors in the survey, some said that they preferred not to have all of their holdings with one broker for security reasons. Others said that they used different brokers in order to gain access to specific asset classes and markets. It is possible to transfer shareholdings from one broker to another. Some brokers offer a free service to transfer in, although there may be administration charges either from the registrar or the existing broker.

Share purchases, sales and research

Equity investors were asked how often they had bought and/or sold shares in the past year, how often they had checked the prices of shares they owned and how often they investigated how the companies they held shares in were doing.

There were some immediate differences between the survey identified equity investors and those from the ShareSoc/UKSA equity investor sample, with the latter much more active, as the table below shows:

- Most ShareSoc/UKSA equity investors (74%) said that they checked the prices of the shares they hold at least once a fortnight (including 59% who checked more than once a week). This was much less common amongst survey identified equity investors (18%, with 11% checking more than once a week)
- At the other end of the scale, 38% of survey identified equity investors said that checking prices was not something they had done in the past year, compared to just 1% of ShareSoc/UKSA equity investors
- Half (48%) of ShareSoc/UKSA equity investors investigated the performance of the companies in which they hold shares at least once a fortnight (with 33% checking more than once a week) compared to a small minority of survey identified equity investors (5%)

- Two thirds of survey identified equity investors said that investigating the performance of these companies was not something they had done in the past year (62%), compared to just 4% of ShareSoc/UKSA equity investors.

Table 4: Frequency of checking company prices and information

Frequency	Survey identified equity investors		ShareSoc/UKSA equity investors	
	Check prices	Company info	Check prices	Company info
Unweighted base	221	221	400	400
26+ times (up to once a week or more)	18%	5%	74%	48%
13-24 times (up to twice a month)	2%	3%	8%	13%
7-12 times (up to once a month)	10%	5%	9%	11%
3-6 times (up to once every other month)	13%	10%	6%	13%
Once or twice	18%	15%	3%	12%
Not in the last year	38%	62%	1%	4%

The differences in frequency of share sales and purchases between the two groups were equally clear, with the ShareSoc/UKSA equity investors reporting more regular activity:

- While 29% of ShareSoc/UKSA equity investors typically bought shares at least once a month, just 1% of survey identified equity investors were trading at this frequency
- Share sales were somewhat less frequent than purchases amongst ShareSoc/UKSA equity investors (21% sold shares at least once a month) but again this was notably higher than for survey identified equity investors (1%)
- Many in the survey identified equity investor group said that they had not bought (73%) or sold (86%) shares in the last year, whereas this was the case for only a small group of ShareSoc/UKSA equity investors (6% had not bought shares and 14% had not sold any):

Table 5: Frequency of buying and selling shares

Frequency	Survey identified equity investors		ShareSoc/UKSA equity investors	
	Buy shares	Sell shares	Buy shares	Sell shares
Unweighted base	221	221	400	400
26+ times (up to once a week or more)	-	-	16%	12%
13-24 times (up to twice a month)	1%	1%	13%	9%
7-12 times (up to once a month)	8%	2%	23%	16%
3-6 times (up to once every other month)	3%	1%	27%	25%
Once or twice	16%	10%	16%	25%
Not in the last year	73%	86%	6%	14%

Those who had bought or sold shares in the past year were asked how they had done this, the last time they had completed such a transaction. As already reported, the purchase or sale of shares was not that frequent amongst survey identified equity investors, so the number of such equity investors answering these questions is limited, especially for sales, and results should be seen as indicative.

Table 6 shows that ShareSoc/UKSA equity investors in particular used very similar channels to both buy and sell shares. The key difference between the ShareSoc/UKSA equity investors and survey identified equity investors was the role (or lack of it) of a broker in their most recent transaction – eight in ten sales/purchases by ShareSoc/UKSA equity investors were done by the respondent (albeit the actual trade will have been undertaken for them by an authorised person) compared to around three in ten for survey identified equity shareholders. One in four of this latter group relied on the broker to recommend and then organise the sale, compared to less than one in fifteen ShareSoc/UKSA equity investors.

Table 6: Channels used to buy and sell shares

Channel last used:	Survey identified equity investors		ShareSoc/UKSA equity investors	
	Bought shares	Sold shares	Bought shares	Sold shares
Unweighted base	64*	33*	377	343
Respondent decision, broker made sale / trade	11%	30%	27%	26%
Respondent made sale/trade online (indirect brokered service)	35%	27%	77%	79%
Broker recommended and organised sale/trade	25%	25%	6%	5%
Used bank branch service	9%	8%	1%	1%
Some other way	20%	10%	2%	1%

*Base size less than 100, results should be considered indicative only

It is perhaps no surprise then that almost all ShareSoc/UKSA equity investors (80%) said that they were happy buying and selling shares without any advice from a broker, compared to 35% of survey identified equity investors. At the other end of the advice

scale, 31% of survey identified equity investors said that they relied entirely on their broker to tell them when to buy and sell, a view shared by just 1% of ShareSoc/UKSA equity investors.

Table 7: Confidence in share sales and purchases

Confidence in share sales/purchases	Survey identified equity investors	ShareSoc/UKSA equity investors
<i>Unweighted base</i>	221	400
Happy buying and selling shares without any advice from a broker	35%	80%
Buy and sell without advice but do value it at times	15%	15%
Tend to buy and sell on advice from a broker but sometimes make own decisions	19%	5%
Rely entirely on broker or other adviser to tell you when to buy or sell	31%	1%

In both groups those who were happy to buy and sell on their own, or who only occasionally sought advice, were more likely to have bought/sold shares in the past year and to have checked share prices or the company’s strategy.

Shareholder rights

17% of survey identified equity investors were unsure what shareholder rights they had, compared to 6% of ShareSoc/UKSA equity investors. Table 8 below excludes these respondents to provide a fair comparison across the two groups:

Table 8: Whether investors believe they have shareholder rights

Whether believe have shareholder rights (excluding those not sure)	Survey identified equity investors	ShareSoc/UKSA equity investors
Unweighted base	166	376
For all shares	47%	27%
For some shares	21%	52%
For no shares	32%	21%

Most ShareSoc/UKSA equity investors believed that they had rights (79%) compared to two thirds of survey identified equity investors (68%) but this latter group were more likely to believe that they had shareholder rights for all the shares they held (47%).

Those who held paper share certificates were more likely to believe they had rights for some/all of their shares:

- 84% of survey identified equity investors who held paper certificates believed that they had rights (excluding those not sure).
 - *Many of those with paper certificates will still receive Annual Reports through the post, although in recent years many will have opted to receive these in digital format.*
- 94% of ShareSoc/UKSA equity investors who held paper certificates believed that they had rights (excluding those not sure).
 - *From talking with shareholder association representatives we would imagine that these investors are more likely to know that rights are automatically associated with paper certificates.*

Table 9: Awareness of shareholder rights for investors holding shares via brokers

Perceived belief that they hold rights to shares	Yes for all shares	Yes for some shares	Yes (any)	No
Unweighted base	78*	35*	113	53*
Proportion holding shares with a broker	27%	40%	31%	53%

*Base size less than 100, results should be considered indicative only

As Table 9 illustrates, of those that believed they had rights to some or all of their shares, 31% were found to be holding shares with a broker (27% of those who believed they had rights for all their shares, 40% of those who believed they held rights for some of their shares).

We cannot tell within the 31% how many held shares with a broker that operated pooled or designated nominee accounts, however a qualitative analysis of the broker market revealed that the default method for holding client shares was a pooled nominee account. Designated nominees were found to be extremely rare therefore we can infer that the majority held shares in pooled nominee holdings.

Pooled nominees are operated in the name of the broker and contain shares from a 'pool' of clients. The shares in the account are registered in the name of the broker, not the beneficial owner of the shares (the underlying investor).

The knock-on effect of the pooled nominee model is that investors might believe they are the 'owner' of their shares, entitled to the dividend payments and the associated benefits, such as the ability to vote and attend AGMs, but in fact they are dependent on the broker to facilitate access to their share rights.

Of the 133 people (31% of all investors) that were found to be holding shares with a broker:

- 30% had asked for rights to be passed back to them
- 43% were unaware they were not entitled to rights (although only 6% claimed they would ask for rights to be passed back now they have been made aware)
- The remainder were aware and had no interest in voting or might request rights are passed back in certain situations i.e. voting on a corporate action.

This analysis suggests there were a large number of investors holding shares in pooled nominee accounts that were simply not aware they did not have access to shareholder rights.

However it is important to stress that the majority of those who claimed to be unaware showed little or no interest in taking up rights once they were better informed.

Amongst those who believed they had rights, attitudes towards those rights were remarkably similar for both groups, as Table 10 shows:

Table 10: Attitudes to rights

Attitudes to rights – those who believe they have them	Survey identified equity investors	ShareSoc/UKSA equity investors
<i>Unweighted base</i>	127	296
It's important to vote and I do so whenever possible	34%	45%
I vote on things that seem important but otherwise don't bother	31%	31%
I don't/rarely vote as I don't think my vote makes any difference	21%	18%
I don't/rarely vote because it is a lot of hassle to do so	12%	13%

ShareSoc/UKSA equity investors were slightly more likely to feel it was important to vote than survey identified equity investors, but similar proportions of both groups just voted on things that seemed important and around one in five didn't vote because they didn't think their vote would make any difference.

A third of survey identified equity investors (38%) and half of all ShareSoc/UKSA equity investors (49%) agreed that if they could vote online just by clicking a button they would vote more often, suggesting that the process is something of a barrier for some shareholders.

Whilst *attitudes* to shareholder rights were similar across the two groups, when it came to actually *exercising* those rights ShareSoc/UKSA equity investors who had rights were much more likely to have done so (89%) than survey identified equity investors with rights (58%):

Table 11: Activity related to shareholder rights

Activity related to shareholder rights	Survey identified equity investors	ShareSoc/UKSA equity investors
Unweighted base	127	296
Any activity:	58%	89%
- Voted by post/online	52%	77%
- Attended an AGM	4%	40%
- Sought information from the company issuing the shares	14%	34%
- Something else	3%	9%
Have not done anything	42%	11%

For both groups the most common activity was voting (77% of ShareSoc/UKSA equity investors and 52% of survey identified equity investors). Whilst only a few survey identified equity investors had done anything else apart from voting, 4 in 10 ShareSoc/UKSA equity investors had attended an AGM and almost as many had sought information from the company issuing the shares.

For both groups activity levels did not vary much by how confident these equity investors were, or by whether they believed they had rights for some or all of their shares, or by whether they were aware of the change in rights when shares are held in a nominee account. Amongst survey identified equity investors activity did correlate broadly with share activity (buying, selling, checking share prices or seeking information on performance) but this was not the case for ShareSoc/UKSA equity investors.

Awareness of impact of nominee accounts on shareholder rights

All respondents were provided with the following description of the impact on shareholder rights when shares are held in a nominee account:

When company shares are held on your behalf by a Broker, they are held in what is called a nominee account. This also includes any individual shares that are part of a SIPP or a Stocks and Shares ISA.

Because the shares are not technically held in your own name, this means that you do not automatically have any shareholder rights such as being able to vote at the Annual General Meeting. Some stockbrokers pass these rights back to the individual shareholders but many do not.

Just under half of survey identified equity investors (44%) said that they were aware of this, compared to almost all ShareSoc/UKSA equity investors (93%).

On limited base sizes, awareness was lower in both groups amongst those who relied on their broker / adviser to tell them when to buy and sell. Whilst almost all the ShareSoc/UKSA equity investors who were happy to buy and sell on their own were aware, this was the case for half of survey identified equity investors who made their own decisions.

The impact of this information was asked separately for those who were already aware and those who were not already aware of the issue. These follow up questions were only asked of those who held shares with brokers. For ease, the table is presented based on all respondents in each group.

A quarter of ShareSoc/UKSA equity investors (23%) had asked their broker for their shareholder rights to be passed back, with half of them (11% of this group overall) saying that the broker had not passed these rights back. Survey identified equity investors were much less likely to have asked for their rights to be passed back (7%) but where they had, all of them had received them.

Amongst the ShareSoc/UKSA equity investors almost half, 47%, were aware of the rights situation and said that they would ask for their rights if there was an important vote. Opinions and likely behaviours were more mixed amongst the survey identified equity investors as Table 12 shows:

Table 12: Survey responses: the shareholder rights situation in pooled nominee accounts

Impact of shareholder rights situation	Survey identified equity investors	ShareSoc/ UKSA equity investors
Unweighted base	221	400
Hold shares with broker and aware of situation	34%	87%
- <i>Asked broker to pass back rights and they did</i>	7%	12%
- <i>Asked broker to pass back rights but they did not</i>	-	11%
- <i>If there was an important vote would ask for rights</i>	5%	47%
- <i>Have no plans to ask for rights</i>	11%	16%
- <i>Does not concern me as would not want to vote</i>	11%	1%
Hold shares with broker and not aware of situation	41%	6%
- <i>Plan to ask broker to pass rights back</i>	4%	2%
- <i>If there was an important vote would ask for rights</i>	7%	3%
- <i>Have no plans to ask for rights</i>	11%	<1%
- <i>Does not concern me as would not want to vote</i>	19%	<1%
Do not hold shares with broker	25%	7%

In summary, ShareSoc/UKSA equity investors were more likely to have undertaken, or to be prepared to undertake, some form of activity. Three quarters of the survey identified equity investors appeared less affected, as they either did not hold shares with brokers, or did hold shares with them but had no plans to take any action regarding their rights:

Table 13: Reported future behaviour regarding rights

Reported future behaviour regarding rights	Survey identified equity investors	ShareSoc/UKSA equity investors
<i>Unweighted base</i>	221	400
Hold shares with brokers and have or will take action to get rights	11%	25%
Hold shares with brokers and would take action to get rights for important vote	12%	50%
Hold shares with brokers but have no plans to ask for rights/ don't want to vote	52%	18%
Do not hold shares with a broker	25%	7%

Equity investor follow up interviews

In order to support and expand these quantitative data, 100 follow-up qualitative telephone interviews were conducted. These interviewees were deliberately chosen to reflect the different equity investor types and were recruited from the survey, the ShareSoc/UKSA survey and also by free-finding other equity investors that met specific criteria (set out below). The 100 interviews were thus not intended to be representative of equity investors overall but to highlight key issues within each specific group. In view of the tight timescales involved in the project, there were no additional quota restrictions set on recruitment; demographics were allowed to fall out naturally during the selection process. The alternative would have been to try and match each sub-sample back to the profile indicated by the survey. However, even this would have been based on very small sample sizes in most instances and would therefore not necessarily have resulted in greater accuracy (and would have taken considerably more time and resource).

A number of these interviewees were selected for a longer interview based on their experiences and some of these are reported as case studies to add granularity.

The follow up interviews were conducted as follows:

- 20 with paper shareholders
- 32 using an execution only service with a broker with a mix of voting rights which are/are not available
- 12 with a CREST account held via a broker
- 29 using an advisory service with a broker with a mix of voting rights which are/are not available
- 7 using a discretionary service with a broker

This sample design was based on trying to split customers by the ways in which they hold shares and whether they have access to information and voting rights. This would have been a relatively straightforward process if all were distinct audiences; but as reported earlier, they are not. Those who have been trading for some time tended to hold at least some paper shares, whether or not they now primarily used an electronic brokerage. Equally, amongst the execution only audiences, there was a high level of multi-brokering, and our analysis has shown that different brokers offer a somewhat different servicing model with regards to information and voting.

In addition, amongst some equity investors, there was confusion as to specifically how their shares were held and thus what rights might be available to them.

It is also worth noting that during the screening process for the survey, levels of consumer confusion were discovered. Whilst for the purposes of this research the word, 'broker' is used in reference to stockbrokers and other providers facilitating trading of individual shares, we encountered many who refer to independent financial advisers (IFAs, who mostly advised on collective investments, such as equity funds) as 'brokers'. Similarly consumers often did not immediately make a distinction between individual shareholdings

(in a single company) and 'investments in stocks and shares', which is also a term applied to collective investments.

This high degree of consumer confusion likely explains the excessively high claimed usage of CREST accounts in the survey data and very possibly a degree of over claiming with regard to holdings of 'self-select' ISAs invested in the shares of individual companies (as opposed to a 'stocks and shares' ISA invested in a UK Equity fund).

Some common themes

As already reported, most invested in shares via multiple methods and in many cases with multiple providers. This being the case, the differences between those who were identified as holding shares via different methods were not highly pronounced.

There was mix of knowledge and sophistication, although in general CREST account holders (who have selected this method), execution only customers (who trade without advice) and discretionary customers (who have significant holdings) were the most knowledgeable and sophisticated.

Whilst there was increased frequency of trading amongst execution only customers (as one would expect) the vast majority of those we spoke with were 'investors' (for the long term) rather than 'traders' (for the short term) with respect to the majority of their investments in individual equities. Most were investing with a view to their retirement.

There was no mention of the issue of privacy or security with regards to being identifiable on a share register. Brokers cited confidentiality and freedom from junk mail as supplementary benefits of nominee accounts. However, this research provided no evidence of this as a customer issue.

There was evidence that part of the reason for some using multiple providers was security; spreading their risk between different brokers.

With the exception of a few of the execution only customers there was little mention of price sensitivity with regards to transaction and administration charges.

Of those who did care about shareholder rights, most cared more about the principle involved than the mechanics of receiving information, being able to vote or attending a company meeting.

The equity investors analysed below are divided into five groups: those holding paper shares; execution only customers; those with CREST personal accounts; those using an advisory service; and those using a discretionary service.

Those holding paper shares

This analysis is based on twenty semi-structured interviews conducted with individuals who hold paper shares. This is a mixed group in terms of their interest in and engagement with the companies they invest in, and not all were aware of the difference nominee accounts could make to shareholder rights. Around two thirds vote (at least occasionally) but not all of them would be negatively affected if those voting rights were lost.

Context (from the survey questions)

Three quarters of this group were male. There was a spread of ages: just over half (12) were under 55, four were aged 55-64 and another four were over 65. Most (17) were working. They all held shares in publicly traded companies, six had a SIPP and fifteen had self-select ISAs. All initially reported that they only held shares on paper, but later in the interview there were mentions of electronic shares and brokers, as demonstrated by the following comment:

“With regards to paper I’m trying to think if my ‘paper shares’ are paper shares or not now. I think many aren’t ‘paper’. I’m a bit confused actually because I don’t even look at the shares unless something happens. I have a feeling that I haven’t got much paper now - I think that they may be more electronic.”

They do not trade quite as frequently as some other groups – seven had not bought any shares in the previous year and almost all the remainder had bought shares six times or less in the year, with a similar pattern for share sales. All said that they were happy buying and selling shares without any advice from a broker. Around half (12) were aware of the difference in shareholder rights that arises from nominee accounts.

Background

Almost all of this group had held shares for a while, typically at least 10-15 years and some for considerably longer (over 40 years in some cases). There were several mentions of buying shares through privatisation, while others were given the shares or inherited them. Most started trading at about the same time as the shares were acquired.

They were looking for a return on their investment, with a mix of long term growth and income mentioned and a chance to make a better return in a low interest rate environment. They see themselves as investors rather than traders and these shares were typically being held for the longer term:

“...growth and making capital for my pension, of late. It is still my intention to retire in the next 5 years and it is going well for me.”

Many amongst this group talked of getting a few shares initially and then becoming more interested in trading and it developing into more of a hobby, especially as technology improved, making it easier to find out more about how companies were performing.

Most of this group talked about holding shares for the longer term, although some had a mixed portfolio with some shares being seen as more of a short term investment:

“They’re all similar. I am not a trader so I don’t deal with any short terms. When I say long-term I mean about 10-20 years, it might be longer.”

“There are differences, some I’ve held for years, some I’ve done for trading purposes, to buy and sell for a quick buck.”

There was also a mix of levels of interest and engagement in the process of buying and selling:

"I look at a blue chip company, buying and investing into it and putting them away for the future."

"I don't do trading on a daily basis, I buy and hold.... looking for a long term income because it grows about five or seven percent over inflation every year and you don't get these sorts of dividends in the bank - you don't even get half a percent nowadays."

"It's a hobby; it's a bit of fun. I don't spend hours researching companies."

Whilst one respondent in this group only held shares in one company, the rest were fairly evenly split between those who had shares in up to ten companies and those who had shares in around 15 to 20, although one respondent did have shares in 50 companies.

This group bought and sold shares in a variety of ways, with many mentioning more than one channel. There were several mentions of using their bank, of brokers and of online portals, while a few applied directly by post for shares. The method(s) chosen were seen as easy and convenient, and those who used their bank commented that it was easy to have everything in one place. A few mentioned choosing a provider that was well known, or had a good reputation.

"Basically, I've banked with them from the time I started work, so it followed on I use their stock broking facilities."

"The charges are reasonable. I find them quite cheap. I don't get advice from stockbrokers. They don't give me advice; they just hold it and do the dealings for you. It's a matter of convenience."

Paper shares were held by the respondents while any electronic shares were held in nominee accounts, with mentions of both pooled accounts and shares being held in the respondent's name. Some of this group were aware of the difference in shareholder rights of the different ways of holding shares, and there were a couple of examples of them having taken steps to amend this:

"I can ask them to send me the details if I want to attend any meetings and such like. I think there is some form of admin fee on that. I was aware at the time that there would need to be some sort of special arrangement for voting or rights."

Others however were not sure what rights they had (and the quote below suggests they may have been informed by taking part in the survey):

"No to be honest, I thought I had the same rights. But I've now learnt that there are certain rights that I do not have and there is a difference between paper share rights and rights on a nominee account."

There was however a general feeling that they were "their" shares, however they were held.

Most reported that they didn't pay anything over and above the transaction fees. There were a few mentions of a small, regular, admin fee which might be paid monthly, quarterly or annually.

Interest in companies

This group exhibited mixed levels of interest in the companies in which they hold shares. Around half appeared very engaged, with comments around following the share price, reading about the company online and reading company documentation when it is sent:

"Yes I do, I try and do as much research as possible. I'm a layman really but I use the internet to try and do as much research as I can and a lot of ground work. Like I said it's a bit of a hobby."

"Every three to five weeks I look up about what they are doing and I will read up about them."

The rest however reported that they did not do much:

"I don't really follow what's happening with these companies. I take things on trust."

The issue of shareholder rights

Most of this group appeared to have access to annual reports, whether received directly or via their broker (and one commented that they retained one paper share in order to ensure they continued to receive them). The extent to which these reports were read varied, with most reading some of the report, rather than all the detail. Around a quarter of this group said that they always read the reports and found them useful:

"I do actually read them and it helps the engagement process. It is useful and it's quite interesting to see in which way the company has been going."

Others ascribed their limited interest to a lack of experience or understanding, or because they did not find the documents useful:

"I get sent it all but I don't read it, sometimes a little glance but I don't delve into it as much, partially because I'm not experienced enough to know what I should be looking for and partially because I'm not too bothered about what it says either."

"Honestly, I've never read through an annual report. Had a quick scan through but not something I would base my decision on. It's a part of my research but not really used much."

Around two thirds of this group had exercised their rights through voting, or attending an AGM, although some reported that they only attend when a key issue was being discussed, rather than as a matter of course and there were several comments that small shareholders didn't make much of a difference to the final outcome:

"I do if I go to the AGM or if it's something I've particularly got an interest in, otherwise I don't vote. To be honest, unless you've got a certain percentage of a company, I don't think you have that much of an influence."

Amongst those who vote, there is a perception that it is a chance to give their opinion, especially if it is an issue they feel strongly about, and help steer the company in the "right" direction (even if they can't necessarily control the final decision):

"It's important when it has a big effect on my companies. I want my companies to do well so I want to be able to vote towards that if it's something I have an opinion on."

Around a third of this group did not vote and showed little interest in doing so:

"I get rights for all of them, but I don't use them. I have never gone to any of the meetings, I'm not interested."

That said, a few of those who didn't vote said that they would if the issue was important enough:

"The circumstance would have to be that I really felt there's something so severe, like a terrible breach, that would make me want to be in a general meeting to see how they mucked things up so badly."

If the company information was not provided, most of this group felt that this could be replaced by searching online for information. The loss of voting rights would potentially have more of an impact amongst those who currently vote, who felt that they would be less inclined to hold shares in those companies in future, and would miss the chance to have their say. But there was a mix of views, with some current voters not too concerned and some who didn't vote thinking they would miss having the option:

"I wouldn't be too bothered because if I wanted to I could go and find it myself and the companies put it on the websites anyway. The information is so readily available now. Not hugely bothered if I couldn't vote but don't think I would hold investments if myself or others didn't have a say and ultimately just had to go along with what others are doing."

"It is reassuring to get stuff (company information). I do feel that at least the process is still there and just because I abuse it doesn't mean it's not there and I guess if you just never heard anything then you really would begin to worry. With regard to voting, I like the ability to be able to do those things even though I don't actually use them. I think it's reassuring."

Case study

This case study respondent was originally from South Africa and has lived in the UK for 27 years. He was an academic specialist in management accounting.

He had held shares for about 50 years, starting when he saw opportunities to invest in South Africa. On arrival in the UK, he looked at all the opportunities to invest in collective investments, but decided that individual shares represented better value and more control.

All of his shareholdings were on paper. He saw advantages both from a personal and a professional perspective:

- As an individual he liked the sense of control and ownership from having shares on paper. He saw this as convenient in that he could trade or transfer when he wanted to and use whatever broker he chose to.
- From a professional perspective he was strongly opposed to intermediation between share issuers and investors and felt that 'brokers shouldn't exclude shareholders and usurp their rights.'

He also objected to the idea of paying a broker to hold shares on his behalf.

He did not vote as he saw no value in this, but did like to read company reports. He estimated that about 90% of these were now only provided to him online rather than through the post.

In summary:

Individual investors hold shares in a range of different ways, either for historical reasons (shares held for a long time) or convenience and many also hold shares electronically via two or more stockbrokers or portals.

In common with other sub-groups, these individuals struggle to compartmentalise their different holdings by channel (paper / stockbroker etc.). Certainly they don't immediately categorise them with regard to the degree to which shareholder rights are available or not.

There is a wide range of interest and knowledge amongst this sub-group. Some have attended AGMs and a larger number would want to vote where they felt that the vote was important either materially or on a point of principle.

Execution only customers

This analysis is based on thirty two semi-structured interviews conducted with those who hold shares electronically. The original intention was to divide this sample between those with access to shareholder rights and those with no access. During the research it became apparent that this distinction is less clear and it is important to emphasise that levels of consumer education in this space are relatively low.

On the whole, execution only investors were relatively sophisticated and knowledgeable with regards to financial services. They understood the nominee structure and some acknowledged that, in effect, they hold an economic entitlement to shares rather than being 'shareholders' as such. This said, only a small proportion was interested in receiving information rights, and an even smaller proportion was interested in voting their shares.

Context (from the survey questions)

This group (execution only investors) was exclusively male. Only four were under the age of 45 and over half were over 65, although five of these were not yet retired. All held shares in publically traded companies, thirteen had a SIPP containing individual shares

and all but seven held ISAs. Twelve held shares on paper as well as with a broker and four also held shares in a corporate nominee.

These were frequent traders. Twelve bought or sold shares at least once per month, and of these three traded more than once per week.

Background

Most of these execution only investors had been investing in individual shares for a very long time: almost all first acquired shares 20 years ago or more. Their main motivation was profit (either as an income, or as a long-term investment for their retirement), but quite a few described investing in shares as a hobby and enjoyed reading about it and looking after their portfolio.

Overall they were mostly focused on the long-term and the most engaged investors chose companies that they had faith in to deliver longer term returns. A few also mentioned shorter-term trades.

These investors used three categories of broker, which impacted on the availability of shareholder rights:

- Brokers who proactively offer shareholder rights to those with shares held in nominee accounts.
- Brokers who offer shareholder rights on request.
- Brokers who do not offer shareholder rights under the terms of their contracts.

There was quite a lot of confusion amongst this group over whether shareholder rights were a) available to them and b) had been taken advantage of:

- A number of respondents 'self-qualified' as being able to vote, when from the brokers used this was clearly not the case.
- Others thought that they were not able to vote when, from the broker used, this was in fact possible for them.
- There were few marked differences between these three audiences. Indeed of those nine shareholders able to vote online with relative ease, only two actually did, although both felt this was very important to them.

The choice of platform was mainly driven by cost and by the convenience of using an online portal. The more "sophisticated" respondents in this group used different platforms in order to gain access to different products and markets.

All mentioned nominee accounts spontaneously, but there was uncertainty as to how these accounts worked and where their shares were physically held, although most knew that their name was not actually on the share register:

"They'll be held in the books of my provider. Some sort of pooled nominee account."

“They are all held in nominee accounts/CREST accounts. I'm not certain how but I do know they are not certificated, but beyond that I don't really know where they are.”

Some investors felt that these ownership structures were designed to protect them. One mentioned that if the broker's office was to burn down, this wouldn't affect their ownership of the shares since they were not physically held there.

However, the predominant view was that there was insufficient financial protection in a nominee account and there was concern as to what broker failure might mean. To mitigate this risk, a few spread their shares across a number of brokers.

“If the company went down I think there could be a potential that I would lose my money.”

“They've set up these silly little companies [nominee companies]. It's extensively removed from the company you're supposed to be dealing with and you're supposed to be protected but I have my doubts.”

Those with SIPPs found it hard to disaggregate the charges they paid for the SIPP and those that they paid for usage of nominee services.

Engagement

Amongst execution only investors, the degree of engagement tended to be lower with electronic shares than with companies for which they had paper certificates. This was mainly driven by the existence of a direct link with the company and that those who owned paper shares received printed annual reports. They tended to vote more often, and in some instances had attended AGMs.

The impact of holding shares via nominee accounts on voting rights was not top of mind for most of these investors. When probed on it, most were more or less aware that the nominee account holder had the proprietary rights over the shares, but in practice some didn't know if they had the right to vote at AGMs. Even those who understood the nominee system indicated that they were not really aware of what it meant for them when they had begun using the broker.

The issue of shareholder rights

Many in this group did not receive any information from their stockbrokers and relied on published information. Annual reports were sent to the most engaged who had requested it (either to the stockbroker or to the company directly). Others mentioned being aware of the possibility of asking the broker for the information but were not willing to pay for this service.

Most relied on information available online (including annual reports if they wanted to read them), and on magazines, and found that all the most up-to-date figures could be found online by those looking for it. Overall this did not create significant frustration, but receiving an annual report from the company did contribute to creating a direct link with its shareholders, and ensured that they didn't miss out on important information.

“The major issue is only beneficial ownership and not being on the main share register. A company could be taken over without you realising the full implications. You might get

something from your broker to say there's been a corporate action but you won't get all the literature."

There was a wide range of attitudes with regards to voting. The few who were heavily engaged with some companies voted, and this created a feeling of participation and ownership:

"I feel like I'm being recognised as an owner of a company. My opinion probably doesn't make a difference but at least I can vote and have a say so I feel like I'm participating rather than excluded. Involvement and a little bit of ownership."

Were these engaged shareholders not able to vote, they said that they would feel like second class shareholders.

Others had voted in the past on matters of personal significance, but rarely exercised their rights for AGMs, either because they felt that they only had a few shares and their votes wouldn't make a difference, or because they lacked information and knowledge about the company.

"I haven't used them for a long time because I don't have a clue of what and who I am voting for."

Lack of access to a right to vote would not discourage these shareholders from investing:

"If I was no longer able to vote, I wouldn't like it but it wouldn't stop me investing."

About half of these execution only investors did not believe that they would be entitled to vote, or did not know. For some holding shares within a SIPP or ISA, there had been a conscious trade off to favour tax advantages against voting privileges. Where they didn't vote, shareholders were not aware of whether someone else (i.e. the nominee account holder) had voted on their shares.

"I was aware that having shares in a Nominee account rather than CREST or paper certificate made it harder to exercise rights. I'm not sure if the nominee has voting rights then transfers them to me..."

Some thought the voting system was complex and felt that it was not worth their effort to vote.

One investor thought that there would be a cost associated with voting (that he wasn't prepared to pay) [this was unlikely to be the case based on research conducted amongst brokers – see below].

A minority felt disenfranchised by the system and would have liked to get more involved and have the rights to vote at and attend AGMs.

'It would be far better if your name was on the share register. The system works quite well, but it's not satisfactory in that the legal owner is the platform or portal. The shareholder is the beneficial owner and receives the proceeds if you sell something. But your name's not on the register, you're disenfranchised. The facility to vote at the AGM is not available but

if it is its costly. I've been to one AGM because I had a large holding but I had to get a letter from the broker to give me the authority to attend, and then when you do attend you can't vote.'

In summary:

Broadly speaking these execution-only investors were somewhat more sophisticated than those who held mainly paper share certificates (although many also held certificated holdings). They tended to understand nominee accounts and some of the benefits and drawbacks of investing using these structures. Whilst they did trade with greater frequency they still regarded themselves as investing for the longer term.

There was mixed awareness as to the degree to which their particular broker (or brokers) facilitated shareholder rights. There was also a wide range of interest with regards to exercising these rights.

Those with a CREST personal account

This analysis is based on twelve semi-structured interviews conducted with individuals who have a CREST personal or sponsored account. There are some 20,000 such CREST accounts in total, meaning that this group represents some 0.1% of CREST account holders by volume.

The primary benefit of a CREST account for many was that it maintained the direct relationship between them and the company in which they had invested. This group was made up almost entirely of ShareSoc/UKSA equity investors who were aware of the difference a nominee account can make and had chosen this path to maintain their information and voting rights.

Context (from the survey questions)

All investors with a personal CREST account were male, and all but one aged over 45. Five were retired. They all held shares in publicly traded companies, eight had a SIPP and 11 had individual shares held in a self-select ISA. All had a CREST account, eight also held shares with a broker, three held paper shares and two held shares with the company that issued them. They were relatively frequent traders with nine buying shares at least once a month and seven selling shares this often. Eight were happy buying and selling shares without any advice from a broker. All were aware of the difference in shareholder rights that arises from nominee accounts.

Background

This group (those with a CREST account) had typically held shares for a considerable time, in some cases 50-60 years, with almost all having had shares for ten years or more. Some were given or inherited shares, others had the chance to buy shares in the company they worked for, or to invest in a company they had connections with (e.g. parent worked there). In many cases the trading of shares started to happen a little while after the acquisition of those first shares and interest had grown from there.

All were looking for a return on their investment and to do better than just leaving the money on deposit – some were looking for medium term growth whereas others were much more focussed on immediate returns and bought and sold shares “unemotionally” rather than thinking about the companies behind those shares. A few respondents described their shareholding style as “buy and hold” but a more popular approach was to have a mix of long and short term investments in their portfolio. A couple had a more determined approach and sold as soon as a certain level of growth had been obtained, or once the shares were no longer delivering what they were purchased to achieve.

Many described it as a “hobby” but there was a sense of them getting involved in, and playing, the market to get better returns – it was very much a hobby “with benefits” (making a return and boosting their financial position). There were many mentions of investigating the market, reading around the companies, perhaps using web forums to decide when and where to invest and little indication that they relied on a broker for advice.

Virtually all shares held by this group were held electronically. A typical shareholding was around 20 companies; the highest was 70 and the lowest six. Only one person still held paper shares (alongside electronic ones) and a number of respondents commented that

they used to hold paper shares but that the system had changed and it was “all electronic now”.

This group mentioned using a range of different brokers. They were selected on cost/value for money but also on reputation or recommendation from others and one chose their stockbroker specifically for the costs associated with having a personal CREST membership. The shares were held electronically, either in CREST or personal / broker nominee accounts and several respondents mentioned also holding shares in pooled nominee accounts and specifically ISAs.

Most were aware when they set up their current arrangements of the impact on shareholder rights of nominee accounts and many commented that this was a primary reason for the choice of CREST so that they continued to receive company information and voting rights:

“It was my main motivation for going for the CREST account. I'm very aware that if you hold your shares in nominee forms then you don't have many or any rights.”

Other benefits of CREST were the ease and security of holdings (holding shares electronically rather than on paper which can get lost).

There was little commonality in terms of charging – a number said they only paid transaction fees. The most common additional fee was an annual fee (around £100-150) or a CREST membership fee while some said these fees were “waived” because of their level of transactions.

Interest in companies

As might be expected, this was typically a very interested and knowledgeable group (although not exclusively so) – they read the financial press, reviewed company accounts, checked share prices and made decisions about which companies they wanted to invest in, sometimes on a daily basis:

“I make a point of attending meetings, presentations, and particularly with smaller companies it's often feasible to meet with directors of the company.”

A few described themselves as “reasonably” engaged – they would read information that was sent to them and maintained a general eye on what is happening but were not as closely involved as others in this group.

The issue of shareholder rights

All but one respondent in this group received company information (and this respondent told us that he was not concerned about not receiving this), either directly from the company or via their broker. This appeared to be a mix of reports sent through the post or downloaded in pdf format. Many then supplemented this with other information that was also provided online, such as share prices, and a few were signed up to online alert services that sent messages when a company of interest made an announcement, as well as reading the financial press.

Most said this information was important to them, especially where they were investing in smaller companies where perhaps less is known about them generally. The information provided didn't necessarily influence their voting behaviour but did influence their decisions about whether to continue to hold the shares. There were several comments made by this group to the effect that they believed that shares held in ISAs did not generate the same level of information or voting rights and that this was a concern.

Most of these respondents voted and did so by post. A few voted online and a few attended AGMs. It was important to them:

"I have a say, my voice is being heard. It's the right to vote and the feeling of belonging"

They also accepted that their "voice" was a small one and unlikely to be decisive, but it was still something they want to do:

"Although as a private investor unless you've got a considerable interest in that company your vote doesn't count for very much as an individual. Never the less it's a very important principle of democracy, its democratic capitalism if you like. So the same reasons why you would want to vote in a national election apply to why you would want to vote for the management of the company that you're investing your hard earned cash in".

For most, not being able to receive this information and participate in voting would be very annoying and disappointing and would cause them to look for other ways of holding shares and/or changing broker in order to rectify the situation. A handful would not be too worried as they were less engaged in the whole process.

Case study

The investor we spoke with is a professional tax expert and former tax-partner at a firm of chartered accountants. He is quite a sophisticated retail investor and invests in a range of other asset classes as well as securities (UK and US).

He first started buying shares in the 1960s when working as a teacher:

"The charges were totally exorbitant. This would cost about 25 or 30 quid in 1975 to buy some shares, to buy £200 worth of shares."

In the mid-1980s he opened his first account with a discount brokerage in Manchester, and bought shares on an execution only basis.

In the mid-1990s he came across a brokers' firm in the Investors Chronicle and started to use their services for electronic broking. This was about the time that CREST was starting up and he was an 'early adopter' for their sponsored personal membership offer.

The reason he found CREST attractive was 'not so much the voting, but the financial accounts'. As a trained accountant, he is able to read and make sense of company accounts and this is how he analyses their performance. These days, he buys larger amounts of shares in a company (perhaps £20,000) and puts them in his SIPP, but then

via his wife's CREST account they purchase about £1,000 in the same company so that they both appear on the register and receive information and voting rights.

"I'm interested in the paper accounts far more than I'm interested in the voting.

He used to pay about £10 a year to be a CREST member. He's read that his broker raised this fee to hundreds of pounds for some clients, but has not had to pay these fees himself. He believes he pays £150 a year and thinks that this is worth it:

"...a stockbroking firm has costs, and quite a lot of those costs are fixed regardless of whether clients are doing anything or not. If their sole mechanism for getting revenue is transaction charges, it gets pretty problematical. So I don't have a conceptual problem with a fixed charge plus a charge every time you buy and sell."

He said that he would prefer to keep his CREST membership rather than go for any of the alternatives available. If his SIPP could be held within CREST rather than in a nominee account this would probably be ideal.

"I'm not a fan of nominee accounts at all. I regard them as a necessary evil for tax-privileged accounts. For non-tax privileged accounts I think it's a way for the broker to effectively get more control over your shares, because they then go round doing stock lending."

In summary:

This sub-group (investors with a personal CREST account) was largely made up from UKSA and ShareSoc members, so may not have been entirely representative of personal CREST members as a population. Ensuring our interviews were nationally representative of the approximately 20,000 CREST personal members nationally, it was not considered feasible with the available time and resources.

Our interviews found that this was the most knowledgeable and interested sub-group and some described themselves as hobbyist investors; investing for the medium term as well as the longer term.

These individual investors have chosen to hold shares via CREST because they are aware of the specific benefits with regards to having their name on the register and being 'recognised' as shareholders by the companies they invest in. Some attend meetings and seek out opportunities to speak with directors of companies.

Those using an advisory service

This analysis is based on twenty nine semi-structured interviews conducted with individuals who usually take advice from a broker before trading.

Context (from the survey questions)

This was a predominantly male group, with a range of ages. Just over half were aged under 55. Almost all of them were working. As well as shares in publically traded companies, half had shares in a SIPP and a similar proportion held self-select ISAs. Almost all held shares with a broker, with some holding paper shares or shares in corporate nominee accounts. They traded, but not necessarily frequently. Two thirds bought shares six times a year or less, and almost all sold at this frequency. Whilst they did involve a broker in their trading, only three said that they always relied on the broker to make decisions for them, the rest were happy to make decisions at least some of the time. Just over half of this group were unaware of the difference nominee accounts make to shareholder rights.

Background

A third of respondents that used an advisory service had acquired their shares in the past decade, with three having only held shares for the past two to five years. The rest had experience of holding individual shares for some time, almost all with 20 years' experience or more, and some for considerably longer (40 years or more).

Respondents mentioned a range of ways in which their shares had been acquired, including through privatisations, having extra funds available from an inheritance or bonus, friends introducing them to share dealing, as a gift or as a company share save scheme.

All bought shares for financial gain, but there were a mix of motivations and also reports of motivations changing over time. Around one in four of this group mentioned buying shares initially for a quick return but that their motivation had changed over time (as they had a family for example) such that they were now looking for long term growth.

“Making some extra money. Since having children my motivations have changed. Initially I was taking more risks so I went from straight high to medium-high. Just to ensure some security for my children's future.”

Others had always been looking for long term growth, to help fund their retirement and to get a better return than from a deposit account. Around a quarter of this group described investing as a hobby and something they had become more interested in over time.

This group had portfolios of varying sizes. Around one in three held shares in only a few companies (five or less) while a similar proportion held shares in around 12 to 15 companies. The remaining four respondents held shares in more than 30 companies with one reporting holding shares in 250 companies. Almost all held a mix of paper and electronic shares.

This group also ranged in terms of their engagement with the process of buying and selling, given that many of the shares were held as a long term investment:

“They're a cross section. I will say that they're a mix of short and long terms. I do not

like to hold shares for too long so most of them would be short term.

“Ideally I would like to hold them for at least the medium term so typically between three and ten years. I would generally only sell if I heard news about a company that I didn’t like.”

“I don’t really “care” what the company is as long as I am making some money out of it.”

This group used a range of stockbrokers to buy and sell shares with around half mentioning using their bank (often alongside another provider). Those using a bank typically also had other accounts with them and so saw it as a natural place to go, while stockbrokers were often recommended initially and then the relationship developed, with several mentions of it having become a trusted relationship:

“Based on recommendation but also because over the years I found that the one I used seemed to offer the best advice.”

“It gives me confidence just to be dealing with one stockbroker and I do trust him.”

All in this group held shares electronically, with a few also holding some shares on paper. Eight members of this group said that their shares were held in a nominee account in their name, while others mentioned pooled nominee accounts and SIPPs. A couple of respondents with a nominee account in their name said this was important to them, but most seemed relatively unconcerned (as long as the shares were held securely), and just five respondents in this group said that they had been aware of the impact on shareholder rights when their accounts were set up:

“Yes it was important but it didn’t influence my decision. I considered it important mainly for security issues and convenience because if I was to sell them they will sell them for me.”

“I don’t really mind about that, my main concern would be the speed with which I am buying and selling shares.”

There were a few comments indicating that some respondents were more aware of the implications on nominee accounts than others, but most seemed fairly unconcerned

“They are owned by the broker/bank. I have beneficial rights. Security – there’s a risk that if the company goes bust at best I’ll have a delay in getting access to my holdings, and at worst there have been cases when stockbrokers have gone bust and they don’t actually own the shares they claim to own. That is why the two pooled nominee accounts I’ve got are with some of the strongest financial institutions in the world.

Half of this group reported paying fees over and above the transaction fees, with mentions of annual fees, administration fees and fees for holding paper certificates. There was no indication from the comments that these fees were viewed as onerous:

“Yes but I couldn’t tell you what they are. They’re not that much.”

“Yes I do. I get a fee if I don’t do any dealing within a three months period. It’s £14.40 and I think it’s to cover the fact that they holding your shares, administration costs.”

"I pay an annual fee with (bank) and with (broker) I pay a Broker fee. It's for maintenance and the advisory element."

Interest in companies

Respondents that had used an advisory service were fairly interested in the companies in which they invested. Most undertook some form of activity, typically seen as keeping an eye on them (including one respondent who follows them on Twitter) and taking an interest. Several mentioned that if they spotted something they would then speak to their broker/adviser:

"I did some research on them to make sure how long they've been running and what their track records were. I also spoke to my financial advisor about it. I will always do my research."

"I tend to do my own research and keep an eye on the companies and my investments myself but if I see that there needs to be some change I will then take it to my financial advisor and try to get involved more."

They used a variety of sources to keep themselves informed, including the financial press, online searches, news alerts and information they received from their broker:

"I do my research through papers, some apps with the share price on my phone and also sometimes online."

The issue of shareholder rights

The majority of these respondents said that they received annual reports, either from their broker (a few request them specifically) or directly from the company. Most looked at them, at least to some extent:

"Yes I do, I think they are useful. To me I go straight to the directors' report and see what they are doing and look at the headlines. If historic I compare with current information in the press."

"I don't read the reports unless I am about to invest some more. Or if there is a big drop or a big gain in the account."

"Very little, I rely more on brokers' comments and investors' analysis."

Most of those who didn't receive annual reports said that they did not feel they were missing out:

"I used to get some of these in the past but reading the annual report is not going to make a difference. It doesn't mean much to me."

There were mixed views about voting rights amongst those who had them:

“It’s a good thing to do, and sometimes I would disagree with what they are recommending.”

“I always vote and I do have some shares that give me benefits, but I wouldn’t say that was the reason I chose to invest.”

“I try not to get too excited about that as I am more interested in how my shares are doing rather than the voting side of it.”

“I have voted but not as much as I should have.”

Those who currently exercised their rights valued this opportunity. Even if their “voice” is not a very loud one, being able to vote made them feel part of the company and involved in their investment:

“I wouldn’t be very happy because I think it’s very important, I am still part of the company and even if I am a very tiny I should have the right to receive information. I wouldn’t be very happy if I couldn’t vote or receive any benefits.”

“I think you should be able to get it, there’s nothing worse than wanting to access information and you don’t have it. I would not be impressed; even if you don’t look at it it’s good to receive it if you need it. - I would not invest if I no longer received benefits.”

However those who did not currently vote would be less concerned, and a few in this group had no idea who, if anyone, voted on “their” shares:

“The annual reports are fine, I think I need to see the annual report to keep an eye on the shares that I’ve got otherwise it would be down to me to chase. As far as the voting is involved I don’t have time to mess about and it doesn’t interest me very much.”

In summary:

Whilst all of these individual investors had a relationship with a stockbroker where the broker advised them on which shares to buy and sell, less than a handful relied exclusively on this advice. Rather, most used the advice to help them to make decisions. Many were also doing some execution only trading of their own outside of this advisory relationship.

Whilst these investors were interested in the companies they had invested in, they were more likely to read about them in the financial news than they were to take an active role in voting or attending AGMs.

Those using discretionary services

This analysis is based on the seven semi-structured interviews conducted with equity investors that use a discretionary service where the broker makes decisions about which shares to buy and sell.

Context (from the survey questions)

This was an older, exclusively male group, and almost all were either retired or of retirement age. All held shares in publicly quoted companies, half had individual shares in

a stocks and shares ISA while none had a SIPP. There was a clear reliance on the broker for all or most trading decisions. Half were aware of the impact on shareholder rights of nominee accounts.

Background

All of this group had held shares for a considerable time – the most recent investor first bought shares twenty years ago, most had been trading shares for a lot longer. The shares were typically acquired as a result of having some capital to invest and a couple of the stockbroker relationships go back at least one generation in that their parents had used the same company.

They were looking to make a profit and for long term growth and typically held shares in around twenty companies, a mix of some paper and mostly electronic shares. The shares were mainly held in pooled nominee accounts, with some mentions of accounts in their own name. Three of the six held shares in another broker, bought on an execution only basis as well as their discretionary arrangements.

Most investments appeared to be for the longer term and this group appeared to have a similar long term relationship with their discretionary broker, selected initially based on recommendation or an introduction. The relationship was maintained due to a high quality of service, trust and value for money, with one mentioning that they had deliberately chosen a smaller provider to get a more personal service.

Most said that they were aware when they started their relationship with the stockbroker of the difference for shareholder rights of holding shares in nominee accounts, although this did not appear to have caused concern or to outweigh the advantages of having the shares held by a broker (being more efficient and requiring less paperwork were both mentioned). Levels of knowledge and engagement were somewhat mixed:

“Yes, I think what happened was at the time, they were paper shares with [a bank] and they were going over to CREST but they were only doing it as a nominee and hence the move. So I knew the rights I had as a shareholder.”

Fees for discretionary management were reported as, ‘somewhere between half a percent and one percent per annum’.

Interest in Companies

Despite buying on a discretionary basis, all appeared quite involved in the companies that they invest in and many were regular readers of the financial press and more specialist magazines.

“I would know all about them in terms of their asset values and what their returns are likely to be and also what their future would be based on the company reports.”

The issue of shareholder rights

Those with a mix of discretionary and non-discretionary brokers found it difficult to recall exactly what information and voting rights they received via each provider:

“With a discretionary managed fund, I have a quarterly summary from the broker of what's going on, where we stand and what they expect.”

“They will come online so I will download the report. They come from the stockbroker and some directly from the companies”

Levels of readership varied, although relative to other shareholder groups, these investors appeared engaged and active:

“I don't spend a lot of time looking at them. Not as much as I should do, but I have a look at them and I also look at printed accounts of the companies that I don't hold any shares in.”

“Annual reports can be really revealing. Depending on the level of financial investigation. I think it's a tremendous source of information.”

Whilst this group might be engaged to the extent of reading the company literature, most had not gone on to vote at AGMs, citing a lack of interest and too much effort being required. They would only vote on important issues:

“If there was a dispute election of a director or a main question affecting the basic function or rationale of the company that was an open issue then I would vote. But there are institutions that decide which way the vote goes. But I do have the choice to attend the AGMs.”

This group mostly felt that being able to vote was important in principle, although they would likely sell if they felt strongly on an issue:

“It's certainly something that would be nice to have. At a certain age you like to have your rights, it should be offered as you should have the rights to vote but then would you actually use it when you have that right? The main vision for buying shares is an investment and that's what I am interested in but if there's a chairman I am unhappy with in the company that I hold shares with or if I didn't agree with the company ethically I would probably sell them. And that would be my vote to sell the shares. Yes it's nice to have a right to vote and an opinion as it's a democratic right.”

“It is unacceptable but right now there's a big hole in investor rights.”

In summary:

Discretionary customers were somewhat different to other investors in that their relationship with the broker was based primarily on personal service. They tended to rely on their broker to provide information about companies rather than seek this information first hand. The extent to which brokers were proactive in passing back information in full (annual reports) or in summary form (quarterly statements) appeared to vary.

Views on shareholder rights were mixed, although most felt that in principle they should have access to these rights. There appeared to be little or no awareness of brokers voting shares on their behalf.

Retail stockbrokers and other share-dealing services

The purpose of this section is to describe the different brokerage options available for individual investors in the UK and to provide perspectives from ‘the market’ with regards to customer usage of and interest in shareholder rights. It also provides an analysis of fees paid by investors for different methods of holding.

Introduction

Individual investors and companies communicate with each other via a chain of intermediaries; the chain has more or less intermediation depending on the manner in which the investor holds shares. Figure 6 illustrates the information flow and intermediation present in the retail investor chain.

Figure 6: The individual shareholder ownership chain

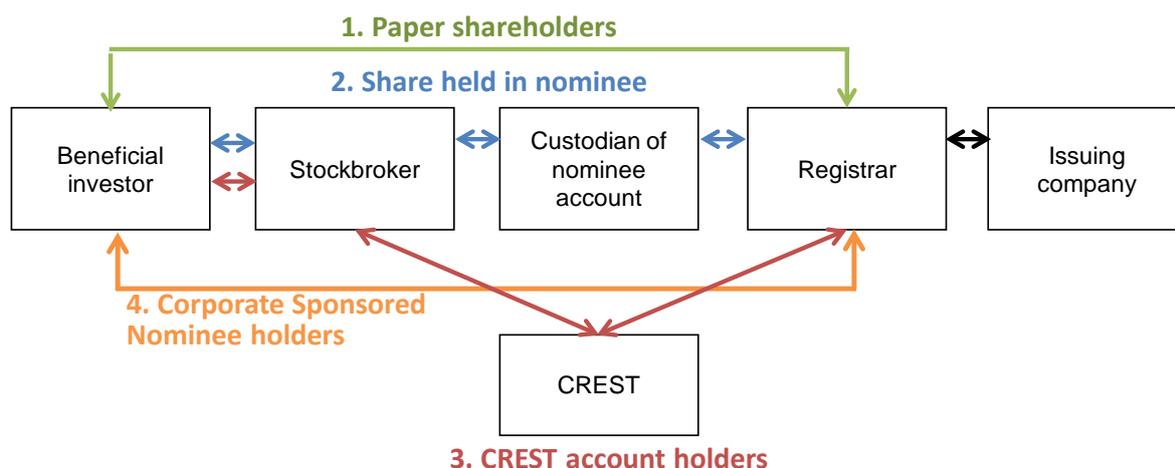


Figure 6 illustrates the ways in which investors are connected directly or indirectly with intermediaries in the ownership chain.

1. Paper shareholders – investors are in possession of their own shares in certificated form. Direct communication between issuing company and investor is possible, albeit via the registrar as the administrator of the share register. Intermediation is minimal and these investors are able to access full shareholder rights
2. Shares held in nominee accounts – investor’s shares are held in dematerialised form by a broker in a nominee account. The vast majority of brokers ‘pool’ shares in a common nominee account which means the investor’s name does not appear on the share register, instead it is the broker’s which is registered. In this scenario communication between investor and issuing company depends on the intermediation of the broker (and may be undertaken via CREST).

3. CREST personal accounts – a small number of private investors use CREST which is a dematerialised way of holding shares (it is primarily used by institutional investors). CREST members receive full shareholder rights and are registered on the share register; however a broker is needed to operate the CREST account on behalf of the investor
4. Shares held in a Corporate Sponsored Nominee (CSN) - investors can hold shares in a nominee operated by the registrar (as opposed to one operated by a broker). The registrar maintains a record of ownership and as such investors can seek to access full shareholder rights with minimal intermediation

Overview of the stock broker market

There are 92 unique brokers trading in LSE (London Stock Exchange) listed equities, including self-directed portals, which offer individual investors direct access to the market. The majority offer a variety of financial services to clients but the market could usefully be subdivided into two broad types of offering:

- The traditional 'Stockbrokers', who buy and sell shares on behalf of their clients either on instruction (execution-only) or on an advised or discretionary basis. Clients for these businesses tend to be high net worth.
- Other participants who offer share-dealing services on an execution-only basis:
 - Banks
 - Online self-trade portals - these tend to attract the 'regular / frequent trader community', but also some who hold shares for longer periods
 - Other providers of share-dealing services under the banner of newspapers or consumer associations (although most are 'white labelled' offerings provided by banks or brokers)
- Private Banks also buy and sell shares on behalf of their clients on request, although most focus on collective investments (open ended and closed ended funds)

An analysis of the brokers trading in LSE listed equities suggested that approximately seven in ten offered execution-only share dealing. A similar proportion offered advisory services and six in ten offered discretionary wealth management.

In recent years online portals, offering execution-only share-dealing, have become increasingly popular with retail investors and these brokers represent a significant proportion of the share dealing market.

Assessing reliable and robust estimates of the market share of UK stockbroking firms has proved challenging. There are a number of ways of calculating market share including proportion of assets held/under management, proportion of the value of trades processed or proportion of the number of trades processed.

If we consider market share in terms of proportion of all trades processed, the dominant players will almost certainly be execution-only brokers many of whom also offer self-directed online trading portals.

An alternative metric by which to measure the market share of UK brokerages is the proportion of assets held/under management. The dominant players in this space would include the dominant execution-only brokers but would also include large wealth management stockbrokers.

It would be very difficult to make any assertions around **numbers** of clients using a particular method, or volumes held. From talking to brokers, the largest share-trading 'platforms' serve disproportionately high numbers of clients, some of whom are frequent traders. Also, traditional stockbrokers serve proportionately fewer clients, but these clients tend to hold much higher volumes of shares than share trading platform clients.

Shareholding methods

Brokers use nominee accounts to hold client shares. Broadly speaking we found there were two types of nominee accounts: 'Pooled' nominees and designated nominees (sometimes referred to as segregated accounts).

Pooled nominee accounts were very common and an analysis of the brokers listed on the LSE suggested nearly every broker used an account of this type. Pooled nominees are operated in the name of the broker and contain shares from a 'pool' of clients. The shares in the account are registered in the name of the broker, not the beneficial owner of the shares (the underlying investor).

- Management charges for individual investors varied considerably. Many of the larger portals make no administrative or custody charges, whilst some stockbrokers charge up to 0.2% (execution only).

SIPPS and ISAs containing individual shareholdings are also held within pooled nominee accounts but tend to be segregated from other shares for tax purposes. This is not the only method set by the Treasury and HMRC, but the only one used in practice.

- There is typically an additional management charge applied to the overall value of SIPPs and ISAs (irrespective of whether individual shares or funds or a mix are held). A typical fee charged by one of the largest portals is 0.45% a year (capped at £45 a year) for shares held in an ISA.

Designated nominee accounts were found to be less common. Designated nominees are operated in the name of the beneficial shareholder and the account holds the investor's shares only. This means shares are registered in the name of the beneficial owner and their name appears on the share register.

Our analysis suggested that approximately one in four brokers offered **designated nominee accounts** (however the default position tended to be a pooled nominee). Where

they were available, designated accounts tended to be offered only at the request of the client and were not actively promoted by the broker.

- We could detect no pattern with regard to whether designated nominee accounts were charged at a higher rate than pooled nominee accounts. It is possible some brokers may charge an additional fee, however we were told that often decisions were taken on a case by case basis taking into account different factors, such as value of portfolio under management and / or the expected volume of trades processed. Designated accounts tended only to be offered by stockbrokers dealing with high net worth clients; where any additional administrative cost is absorbed within the overall value of the relationship.

It is important to bear in mind designated accounts were found to be very rare; we estimated only one in four stockbrokers operated designated accounts (and in many of these cases only on specific request). It is therefore likely that brokers do not need to develop formalised charging structures because the volume of designated accounts in operation is so low.

We hypothesised that the cost of service associated with running a small number of designated accounts was negligible. However the majority of brokers we spoke to expressed a view that the cost of operating designated accounts for every client could be considerable, as it would increase their administrative burden

We believe there are important contextual factors which sit behind this situation:

- Most retail investors are not aware that shares can be held in designated accounts. As such they do not question the pooled nominee model.
- Brokers have little or no incentive to promote designated holdings when they admit the pooled model is administratively simpler to operate.

For both pooled and designated nominee accounts, a custodian was employed to operate the account. Some of the largest brokers were their own custodian but most outsourced this function to a third party.

CREST (personal) membership

CREST membership was found to be common amongst institutional investors but used sparingly by retail investors. Shares in CREST were held in dematerialised form and in the client's own name; CREST records were reconciled with the company share register daily.

We estimated one in five brokers¹¹ offered CREST membership and they tended to be larger brokers holding considerable client assets. The latest estimates suggest there are around 20,000 sponsored CREST accounts in operation in the retail investor space¹². Our

¹¹ Based on a qualitative analysis of the UK brokerage market, primary research with senior representatives of brokerage firms and desk research

¹² Based on primary research conducted with representatives of CREST Euroclear

nationally representative survey data suggested there were 12-13 million retail shareholders in the UK¹³; a similar analysis undertaken by the UK Registrars¹⁴ concurred with this estimation. 20,000 investors with CREST personal membership is equivalent to less than 1% of the total number of retail shareholders.

Of the brokers that offered CREST membership that we spoke to, few had an established charging structure. Those that did not, openly admitted the cost was bundled in a client's management fee.

Amongst those that had a formal charging structure, prices were varied but an additional fee of around £50-£100 per year was levied (in addition to portfolio management and/or transaction charges). There was some flexibility over the frequency of charging but the most common arrangement found was quarterly billing.

Most brokers facilitate information rights on request

Approximately three in four brokers claimed they were willing to pass information rights back to shareholders for shares held in nominee accounts. Of these, one in five reserved the right to charge clients an additional fee for this service (in addition to portfolio management and/or transaction charges). However, our research indicates this rarely happened. Where it occurs, we estimate a client could be charged in the region of £10-20¹⁵. Typically, this would cover the cost of requesting copies of the annual report from the company and forwarding to the beneficial owner of the shares.

It is important to stress that while brokers were willing to pass back rights 'on request', very few brokers were found to be actively encouraging clients to take-up information rights. At the same time it is also important to note that annual reports are easily accessible via company websites and can be accessed and printed if needed. Furthermore annual reports tend to contain notifications such as the date of the next AGM.

Voting rights are also available on request for the majority

Brokers and other platforms vary quite considerably in terms of the degree to which they make voting simple and easy for their clients in nominee accounts. Some of the larger providers supply online voting, where clients can log in to access their rights to vote for the companies they have invested in. Others provide this facility, but only for the largest and most popular PLCs. Others still provide no online facility but will provide voting on request, but here the client would need to write an email or letter for the broker to forward to the registrar.

Around four in five brokers stated that they facilitated voting rights for clients, of which about a quarter reserved the right to charge for this service. However, as with information

¹³ Based on extrapolating the findings of our survey to the UK population as a whole

¹⁴ Based on analysis of the share registers of Equiniti, Capita and Computershare. Collectively these companies register 99% of the total number of shareholdings in the UK

¹⁵ Based on a qualitative analysis of the UK brokerage market, primary research with senior representatives of brokerage firms and desk research

rights, there was limited evidence of brokers actually levying this charge and this might be related to the economies of scale associated with the task. We were told that very few retail investors proactively ask to vote on their investments in individual shares. One of the largest trade portals estimated they receive less than two hundred vote requests per year from a customer base that exceeded 600,000 investors.

Voting does not appear to be actively encouraged by most brokers, although a few do highlight the ability to vote online as a feature of their service.

Amongst survey identified equity investors, who **held shares in a broker nominee account and believed they had share rights**, half had voted online or by post in the last 3 years.

This would suggest the incidence of voting amongst retail investors is higher than brokers suggest. However it is not completely clear:

- We do know investors are much more likely to vote on major issues, such as Corporate Actions, rather than routinely vote their shares for AGMs.
- We cannot know whether a single vote was cast in the last three years or lots of votes were cast.

Equally in undertaking work in this sector, we have observed that self-serve portals attract a certain type of investor, one with a more active trading pattern than the type of investor using advisory or discretionary services. As such it is perhaps not surprising that voting incidence was exceptionally low at the trade portal mentioned above.

Attendance of AGMs is facilitated on payment of a small fee

As with information and voting rights, a majority of brokers claimed they were willing to organise AGM access for their clients, but on request only. Brokers stressed take-up was extremely low but most charged an administration fee to liaise with the custodian and produce a letter that confirmed the beneficial owners' status and right to attend an AGM.

Our research suggested the average charge to the client was in the region of £20 per request to attend an AGM¹⁶.

Whilst a number of brokers reserved the right to charge for facilitating voting and information rights (but rarely did), we believe most brokers do charge clients to organise access to an AGM, and the fact that a fee is charged suggests they regard the task as labour intensive, at least compared to facilitating voting and information rights. The proportion of retail investors attending AGMs was negligible.

¹⁶ Based on a qualitative analysis of the UK brokerage market, primary research with senior representatives of brokerage firms and desk research

The ownership and voting chain from the broker perspective

In this section of the report we analyse shareholder rights from the broker's perspective, starting with the role of nominee accounts in the intermediation chain.

Nominee accounts

The benefits and disadvantages of nominee accounts have been discussed at length¹⁷ and it was not within the remit of this project to recap these arguments. The purpose was to assess the impact nominee accounts have on the ability of underlying shareholders to exercise rights – should they wish to.

The key issue identified was:

- Investors holding shares in pooled nominee accounts did not automatically receive shareholder rights because they did not appear on the company share register and as such were not 'visible' to the issuing company. In order to receive company information, vote shares and attend AGMs the broker who operated the nominee account, had to facilitate access for their client.
- At present, this 'barrier' is overcome if the nominee account is designated in the name of the investor and hence is visible to the registrar. However, as we have seen few brokers offered these accounts preferring the pooled nominee model.

Brokers identified a range of reasons why pooled nominee accounts were widely used.

Brokers believed pooled nominee accounts were the most efficient way of working.

There was a view in the broker community that pooled accounts represented the most cost-effective and efficient way for them to hold client shares:

*"Nominees make it far easier for a stockbroker to operate, we don't want paper, we don't want certificates. We would much rather everything was held electronically."
(Full service broker)*

There was also a view that the underlying investor benefited from the pooled nominee model because it was streamlined and cost savings were passed to the investor.

Aside from indirect cost savings, brokers suggested pooled nominee accounts were beneficial because clients can trade at a greater speed and did not need to wait for paper shares to be transferred manually:

"They don't have a paper trail with share certificates (in nominee accounts). Everything will be done online, everything will be done in the same place so all your investments, your shares, are held in one particular place." (Online self-directed portal)"

¹⁷ <http://www.londonstockexchange.com/traders-and-brokers/private-investors/private-investors/about-share/how-hold-shares/how-hold-shares.htm>

Brokers promoted pooled nominee holdings as a mutually beneficial arrangement. Clients benefited from reduced fees made possible by streamlined and efficient share dealing and in return brokers did not have the administration burden of processing large volumes of paper share certificates.

All the brokers we spoke to stressed that pooled nominees streamlined their service model and the knock-on effect was that clients were serviced at a reduced cost. Certainly some of the individual retail investors we spoke to contrasted the cost of trading shares today with the very high costs paid in the era before electronic broking. Without analysis of brokers' internal accounts (which would be highly commercially sensitive) it is impossible to determine whether all the reduced costs of operating pooled nominee accounts are passed on to investors.

Some individual investors did voice concern that brokers favoured pooled nominee accounts because these were a source of revenue.

“Stockbrokers love nominee accounts, they claim they are easier and cheaper to operate but the real reason they like them is it means that when the company pays the dividend it goes into the nominee account and typically sits there, so they get a cash flow and they get interest on that...a lot of the profits historically have come from that cash flow.”
(Shareholder association representative)

There is a difference between a streamlined service model which allows savings to be passed to the investor and a service which generates additional revenue for the provider.

However, there was limited evidence to suggest brokers generated substantial revenue from pooled nominee accounts.

Brokers pointed to FCA regulations against retaining client funds beyond thirty days and low interest rates as evidence that interest accrued on client dividends does not offer a substantial return:

“Interest rates are a complete wreckage now and anyway the regulators have said that money can only be left on deposit for up to thirty days. So actually interest earnings for brokers are absolutely pathetic these days” (Execution-only broker)

That is not to say pooled nominee accounts did not provide a revenue stream in the past, however we did not encounter any evidence to suggest this is still the case.

An alternative revenue source, and one which was found to be common in the institutional investor space, was stock lending. Institutional investors viewed the practice of loaning client securities as an established practice but it was widely accepted that it was not suitable for the retail shareholding environment:

“Most retail brokers wouldn't permit their stock to be lent.” (Full service broker)

However, there were exceptions. We found terms and conditions for one broker which 'reserved the right' to lend stock either directly or via a sub-custodian.

A share dealing service, one of the banks, also mentioned stock lending in its terms and conditions, but suggested that this would be done only by prior arrangement with a client and that earnings from this activity would be provided on client statements.

Pooled nominee accounts vs client retention?

Some commentators have suggested brokers favour nominee accounts because they 'lock' clients into trading relationships.

"Stockbrokers want to retain control over their clients and this is why they promote nominee systems." (Shareholder)

They also pointed to the 'transfer out' fee that some brokers charged to move shares out of a nominee account as evidence that clients were financially penalised if they wanted to shop around.

It should be noted that the average retail investor is not a regular trader and as such a small number of investors pay this fee. Our nationally representative survey study suggested that of our estimated 12-13 million retail shareholders in the UK, 73% have not bought shares in the last year and 85% have not sold shares in the last year.

It is impossible to say to what extent (if any) the pooled model was conceived with the intention of retaining client business. Some brokers suggested the pooled model came into being as a result of the mass privatisation of state industries in the late 1980's. The privatisation of state companies swelled the national pool of shareholders to such an extent that the paper shareholding model became costly to operate. The administrative burden of transacting high volumes of paper certificates meant that the industry needed a more efficient way of transacting shares:

"In the eighties when you had a number of government nationalisations, suddenly there were lots more shareholders and lots more paper to process. I think it made sense to dematerialise and not to have to worry about keeping hold of a piece of paper." (Full service broker)

To what extent are designated nominees a better option?

Designated nominee accounts were found to be rare and this was largely due to the perceived administrative burden of operating unique client accounts:

"I think back in the day it was easier to set up a designated nominee...as things have moved forward, there are very few firms, and I'm really struggling to think of any, maybe one I can think of that still operate a designated nominee" (Full service broker)

Brokers suggest the pooled account model allowed them to keep fees to a minimum whilst a designated model would be more expensive due to greater administration / transaction costs. The issue of greater transaction costs became more pronounced where the designated account was reconciled in CREST:

“Yes, of course they are more expensive (designated accounts), there is a lot more administration, but also you're paying charges for every single one of those individual transactions (as opposed to a single transaction charge in a pooled account).” (Full service broker)

In discussions with brokers, it became clear that pooled nominee accounts were their preferred model. They readily discussed the additional difficulties (and costs) that would be associated with running individual designated nominees for each client. However there were brokers that offered designated accounts and it is difficult to say to what extent the resistance found was born of the fear of additional complexity or simply that it would not fit their current business model.

Some users raised concerns about security of pooled nominee holdings - but brokers suggested clients were satisfied their investment is safe

“(Regarding nominee holding) we do have clients ask about security and how safe their money is with ...and that’s a perfectly natural question and we detail it on our website and explain on the helpdesk.” (Execution-only broker)

However it was not clear whether the consequences of nominee account holding were fully understood by clients. Brokers referenced pages on their website or contractual terms and conditions as examples of transparency but this cannot confirm that the investor has a full understanding.

Horror stories, such as the collapse of MF Global¹⁸, illustrated the potential for brokers to access client funds to cover business losses; they also highlighted the challenges of compensating clients who held funds in a pooled nominee account. Where a broker has been declared bankrupt, the security of shares held in pooled accounts is arguably more dependent upon accurate record holding of the broker. Validating ownership against the share register would be dependent on the records of the broker and administrators would need to examine these to determine ‘who owned what’. Whilst brokers reluctantly conceded that technically this might be an issue, they suggested clients were satisfied their investment was safe:

“They're obviously the most efficient way for us to possibly hold (pooled nominees)... there’s no question that we have to provide records.” (Full service broker)

“People generally understand the pooled nominee is a place where we act on their behalf but their money is kept ring-fenced from the company finances.” (Execution-only broker)

Designated accounts might make it easier to compensate clients but brokers suggested they do not actually offer greater security regarding the threat of investment fraud.

¹⁸ MF Global, formerly Man Financial, was a USA based major global financial derivatives broker, or commodities brokerage firm. A series of perceived liquidity problems and large fines and penalties dogged MF Global starting in 2008, and led to its bankruptcy in 2011

Brokers argued that shares held in a designated nominee account were equally accessible as those held in a pooled environment – if a broker is trying to defraud their clients. After all, a broker has to be able to access client shares in order to trade on their behalf:

“If somebody is going to defraud you of your investments, whether they need to defraud you from one account or from picking it out of several accounts, if there's going to be fraud and they're going to contravene the regulations, they're perfectly capable of doing it from either account.” (Full service broker)

However, brokers believed the security question was a moot point for most retail investors because the Financial Services Compensation Scheme (FSCS) protected clients against broker fraud and failure.¹⁹

“As a retail investor, unless you've got an awful lot of money you are quite well protected anyway.” (Full service broker)

However, compensation claims would be dependent on evidencing ownership in the pooled nominee account, which in turn would rely on the record keeping of the broker.

So why not offer CREST personal membership to all?

The various concerns raised about nominee holding, regardless of whether the account is pooled or designated might be seen as strengthening the argument to offer CREST personal member accounts as the default holding method.

- CREST offers the same benefits of dematerialisation that brokers champion for nominees. There is no 'paper-trail' to manage/process and shares can be traded quickly
- CREST offers enhanced security since it is reconciled against the share register and thus provides a separate record of ownership
- Shares are registered in the name of the shareholder which means shareholders and issuing companies can communicate directly, without the need for broker intermediation

Despite the apparent benefits, CREST personal accounts were found to be rare and whilst this supports the broker view that investors were satisfied with the security of nominee holdings, it does not explain why CREST was not more widely promoted as an alternative to nominee holding.

There are a number of potential barriers which are explored below.

¹⁹

The FSCS does not protect individual investors against falls in the value of their investments, but it would offer recourse in the event of a broker failing or fraudulently using client funds

Cost

Brokers suggested CREST accounts can be unnecessarily costly because there is a higher set-up fee, driven by the need to connect to the CREST system and a higher transaction cost, driven by the need to reconcile share dealing with CREST. There is also the related administration cost of managing unique client accounts. Whilst the set-up fee is a single expenditure, the on-going administration costs make CREST a less attractive option than the pooled nominee model.

However, despite this view, we did identify examples of cost-effective CREST usage, for example a trade portal that allowed cost-effective share dealing linking to the CREST system. This suggested broker reluctance to use CREST more widely was, to a certain extent, linked to a desire to continue with current operating models.

Investor awareness

Levels of consumer education were reckoned to be low, certainly regarding shareholding options, and as such there was little incentive for brokers to explain or promote CREST to investors. There was no evidence to suggest investors were actually discouraged from using CREST but very few brokers offered sponsored member accounts.

CREST as a 'value add', rather than the standard offering?

*"We might attract some clients with sizeable holdings because we offer CREST options"
(Full service broker)*

It was unclear if CREST would be used more widely if it were actively promoted by brokers. However it should be noted that one broker saw CREST as a way of attracting customers and this suggested there was a viable market in the retail investor space.

Current uptake of CREST membership can be interpreted in two ways: it is either reflective of a low market appetite or reflective of the level of market education, or brokers have limited incentive to address either of these barriers.

Summary of holding methods

The intermediary / broker market is uneven in structure. Stockbrokers service a relatively small number of high value clients, offering discretionary and advisory services as well as execution only (in some instances). Banks and other share dealing portals offer execution only services to a much larger number of lower value clients.

Since partial dematerialisation, the use of pooled nominee accounts has become widespread and is now reckoned by brokers to be the dominant holding method. These structures are convenient and low cost for brokers to administrate.

Pooled nominee accounts have also become the default choice for brokers when administrating individual investor shareholdings held within tax wrappers (SIPPs and ISAs).

The use of designated nominee accounts appears rare and restricted to high value clients of certain stockbrokers. Similarly the number of CREST accounts has fallen in recent

years, as has the number of stockbrokers offering / promoting this holding method (although one higher volume / lower value portal does offer this as standard).

Information and voting rights for clients in pooled nominee accounts

The Companies Act 2006 did not make the facilitation of shareholder rights compulsory for brokers holding shares in nominee accounts.

The majority of brokers claimed they were willing to facilitate information rights for shares held in pooled nominee accounts *if requested*. However, there was a common belief that beneficial owners had little appetite to exercise these rights.

“Going into nominee was a blessing in disguise for some people. Take the example of..., most clients do not want to read a fifty page report, the media covers major events, they don’t want to read the company statement.” (Full service broker)

Brokers believed this justified their view that nominee accounts were attractive because they shielded the investor from unwanted information and interference.

There was a further dynamic; brokers that managed client portfolios argued that they were employed to look after their client’s interests and this included receiving relevant company information and acting accordingly.

“If we need to get in touch we will, by holding shares in nominee you won’t get letters all the time asking you to make decisions” (Full service broker)

Despite their view that there is little demand, there are some notable examples of brokers actively facilitating information rights for clients. It should be noted that these brokers stressed they see this as part of their stewardship responsibilities and admitted take-up was extremely low.

Case study information rights – broker A

- Broker A provided an online platform that allows clients to order copies of annual reports (mainly electronic copies, hard copies are available on request).
- Clients could request reports for all of their holdings with broker A and there was no charge for this service.
- It allowed investors to request reports direct from the issuing company, reports were then sent direct to the investor and were not forwarded by broker A.
- Investors were not made aware of the date of AGMs by this system.
- However the date of the AGM is shown in an annual report and an investor could log-in to broker A’s secure website and vote shares using an electronic proxy voting card. Broker ‘A’ conducted validation checks to ensure the user was in fact the beneficial owner of the shares.

The same platform could be used to submit voting instructions:

- Investors could submit votes five days before the AGM began.
- Broker 'A' aggregated votes and merged them with those from holdings they controlled (mostly those of discretionary clients who they vote on their behalf).
- The vote was communicated to the Registrar via the CREST system.
- This system was in place for the benefit of execution and advisory clients that wished to vote, however the vast majority of broker A's clients were discretionary-managed.
- Where execution and advisory client shares were not voted by the client, no vote was cast.
- After a vote had finished broker A published the results on their website.

The majority of brokers claimed they were willing to pass voting rights back to their clients for shares held in pooled nominee accounts.

However it was usually at the request of the client - very few brokers were found to be actively promoting voting rights:

"If people have bought a share through our nominee service, they won't automatically get notified of things like the rights to vote, but they can always contact us and say I hold this share and I'd like to claim my entitlement on it to the perk or to vote at the meetings or vote by proxy or something or attend an AGM." (Self-directed trade portal)

Votes were usually pooled before sending and submitted as a single entry in the name of the broker. This did not create an audit trail for specific votes and there was rarely any way for an investor to confirm their vote had been placed in accordance with their instructions.

Brokers believed retail investors had limited appetite to vote shares.

The consensus amongst brokers was that retail investors were largely uninterested in voting and this strengthened the case for pooled nominees where the client was shielded from unwanted information.

"We did a survey of our clients some years ago asking if they were interested in voting - we got twelve responses back (out of thousands of clients)." (Full service broker)

The view was consistent across different types of brokerages, regardless of whether they operated for discretionary clients, or offered execution-only share dealing, online or in the traditional manner:

"All our clients are managed clients and they're not interested in having information from companies. So it shouldn't be necessary for a discretionary broker to pass opt-in rights." (Discretionary wealth manager)

“Of our 600,000 plus clients, I think we have around about 160 that choose to vote a year so it's a very small number.” (Self-directed trade portal)

There was also a sense that brokers believed retail shareholders votes were largely symbolic - unless they held a significant proportion of company shares.

“A lot of people don't bother voting, principally because what difference is it going to make?” (Full service broker)

Equally brokers were somewhat dismissive of the type of retail investor likely to attend an AGM.

However, this was somewhat at odds with the considered views of individual investors. Whilst the data showed that few have attended an AGM, more would want to attend if there were an issue of significance at stake, such as a merger or other highly contentious issue. Equally, some of the investment managers we spoke to suggested that individual shareholders played an important role in contentious AGMs if only that their presence and mood had an effect upon management.

Broadly speaking, brokers believed an investor's primary interest was the performance of their stock. Exercising shareholder rights, principally the ability to vote, was relatively unimportant in comparison.

“Most people are more interested in the value their shares are producing, the best way to show your displeasure with a company is to sell the shares. People have the ability to vote but they choose not to.” (Execution-only broker)

However brokers acknowledged there are exceptional circumstances when investors may wish to exercise their vote. The most obvious example was in the event of a corporate action, such as a takeover or a merger with another company, or where a decision might have a significant impact on the share price.

For wealth managers, the subject of voting was a relatively simple matter and the consensus tended to be that clients entrust their portfolios to their care.

Those clients had chosen a 'hands-off' approach and this covered voting in the same way as it shaped investment decisions.

“We allow our fund managers to vote because they have chosen the stock and they are best placed.” (Advisory discretionary broker)

Some discretionary managers maintained a stewardship committee to make decisions on voting client shares. In conjunction with the portfolio manager, they decided how the shares would be voted. Others employed a third party agency to provide detailed company information to inform voting decisions and the cost of this tended to be bundled in a client's management fee.

In contrast execution-only brokers tended not to vote shares unless specifically requested by the end client, which meant a significant proportion of shares were not voted.

“We don’t vote the shares unless we receive instructions.” (Execution-only broker)

Our research highlighted that the majority of brokers were willing to facilitate voting rights for their clients and that, in the majority of cases, this service was not chargeable. However very few investors voted regularly and it was unclear whether charges would become more common if greater numbers started to submit votes. Brokers believed retail shareholders had little interest in voting, and that the performance of the investment is key. They justified this view by pointing to the low incidence of voting amongst retail customers.

The current situation was found to be one of ‘consumer pull’ rather than ‘broker push’ – most brokers claimed they would facilitate voting on request but there were examples of brokers who went a step further and actively promoted voting. The case study beneath is an example of this and their customers have the opportunity to receive company notifications and vote shares electronically.

The question remains should brokers do more to promote shareholder rights? Or is it enough that they will facilitate rights if requested? The phrase “you can take a horse to water” has been heard several times in the course of this research and it encapsulates the broker view of retail investor’s desire to exercise shareholder rights.

Case study voting rights – providing a ‘Part 9 service’

Broker B offered what it is termed a ‘full Part 9’ service.

‘Part 9’ refers to the relevant part of the Companies Act 2006²⁰, under which brokers may pass back shareholder rights to the beneficial owners of the shares. Brokers are not obliged to pass back rights.

- When an investor opens a share dealing account with broker B they are invited to fill in a profile.
- At this point they were asked if they would like to opt-in to receive company information, including notifications
- Those who opted-in received annual reports direct from the issuing company
- They also received summary financial statements, notifications about impending corporate actions and notices of general meetings and circulars
- They could also submit votes online through the secure system
- Company information is available to them by email or post and AGM access can be arranged if they contact the broker directly

²⁰ <http://www.legislation.gov.uk/ukpga/2006/46/part/9>

In summary

With regard to the fees that individual investors pay to brokers, some did pay a fee for administration and custody; in effect a fee for 'holding' shares on their behalf; although many did not. However, transaction charges and fee models varied significantly between brokers and it was not possible to ascertain the degree to which these administrative costs were covered by transaction fees by brokers who did not charge for account management. Equally, transparency around fees varied significantly. Some stockbrokers clearly set out fees for administration, custody and transactions (at different sizes and via different channels).

Individual investors held their shares in a variety of ways. Our survey identified that just over one in four (27%) only held shares in certificated (paper) form, but of the remainder, 45% held shares via more than one method. From the qualitative interviews we conducted, it became clear that not only did individual investors hold shares in different ways, but many of them invested with more than one broker (to obtain lower transaction fees, to gain access to other products or markets, or to spread risk). Amongst execution only customers we did not find any evidence of switching brokers or of customers consolidating their holdings with one broker. Fees were generally levied by a broker when a request is made to transfer holdings from their brokerage to another broker, so this may explain why investors simply chose to open another account with the result that they held shares with multiple brokers.

Other than those with personal CREST accounts, who have chosen to hold in a particular way, decisions on how to hold shares were driven more by circumstance and convenience than design, and we encountered very few investors who had chosen a particular broker or holding method based on the availability of shareholder rights. We saw no evidence that individual investors would seek to deliberately distance themselves from the companies they invest in. Rather we saw evidence that some were unhappy with the degree to which they had become distanced from these companies over time as they had migrated (for convenience) to electronic trading via a broker.

Some brokers (including some of the larger bank portals) did not offer to pass back shareholder rights to individual investors. Other brokers offer shareholder rights on request, and these tended to report very low demand from clients. Others still facilitated shareholder rights via online voting systems for some or all UK shares. Only one or two brokers were proactive in the way that they promoted shareholder rights access to clients.

The Institutional Investor Chain

This section of the report focusses on the investment chain for institutional investors, illustrates the variations in the chain for different sizes of investor and briefly describes the role of each intermediary involved.

Introduction

For reasons outlined in the historical perspective on share ownership at the beginning of this report, long and complex chains of investment have evolved between companies and investors.

A key caveat when reading this section is that this report focusses on UK based investors owning and voting on UK shares in UK companies. The degree of complexity rises still further for UK institutions holding shares in other markets or UK securities held by overseas institutions as these chains involve sub-custodians and CSDs in other markets.

Legal title to the shares is typically held on behalf of institutional investors by a nominee company operated by custodians. Historically, custodians were banks who protected investors from the risks of holding paper shares by storing them on their behalf. As securities markets have become faster, more complex and more global, these custodians have specialised in handling the operational aspects of investment on behalf of investment managers who focus on investment strategy and decisions.

Legal title to the shares is evidenced by entries in the register, and for institutional shares which are held in dematerialised form CREST is the primary source. Registrars keep a secondary record of shareholdings in dematerialised form on behalf of each company, alongside a record of shareholdings in certificated form (paper shares held by individuals) for which they are the primary source.

Just as stockbrokers pool the shareholdings of individual investors, institutional investors' assets are often pooled at one or more stages of the chain either at the level of the investment manager or at the level of the custodian or both. Later in this report, the effects of pooling with regards to share ownership and voting are examined in more detail.

Institutional Investors

In order to examine the investment chain from an investor perspective, it would seem appropriate to begin by describing those institutional investors who are the 'owners' of shares and other assets (whilst not forgetting that this 'ownership' is itself on behalf of many thousands of individuals).

There are four main types of institutional investor:

1. Pension funds

2. Insurance companies

3. Open and closed-ended funds offered to both institutional and retail investors

4. Other investors, including charities, sovereign wealth funds and foundations

There are significant inter-dependencies in that pension funds, insurance companies and other investors invest in open and closed ended funds. Additionally many of the largest asset managers are subsidiaries of insurers.²¹

Pension funds

There are two types of pension scheme: trust-based and contract-based.

Trust-based pension schemes are established under a trust and administered by individual trustees or a corporate trustee. The trustees have a general duty to act and exercise their powers in the best interests of the scheme membership. Trust-based schemes can be either single-employer or multi-employer.

Trust based schemes tend to be defined benefit, otherwise known as occupational pension schemes, where pensions are based on a proportion of final salary or some similar measure.

In 2014 there were 6,057 trust-based schemes²² in operation with wide variation in terms of size and assets. There are a few very large schemes with tens of billions of pounds in assets, and a further hundred or so large schemes with assets of more than £2.5 billion. Below this, there are many thousands of much smaller schemes holding much smaller sums.

Table 14: Mean values of assets for trust based schemes

Members	Number of schemes	Proportion of total	Mean value of scheme
2 to 99	2183	36.04%	£6 million
100 to 999	2680	44.25%	£38 million
1000 to 4999	802	13.24%	£218 million
5000 to 9999	187	3.09%	£743 million
10000+	205	3.38%	£3.5 billion
Total	6057	100.00%	£188 million

Source: Pensions Purple Book 2014

Contract-based pensions involve a contract between each individual member and a product provider. There is no direct contractual relationship between the employer and the

²¹ The Investment Association Report provides an overview of the structure of the UK investment industry: <http://www.theinvestmentassociation.org/assets/files/research/2014/20140909-IMA2013-2014-AMS-chapter1.pdf>

²² According to The Purple Book, prepared by TPR and PPF: http://www.pensionprotectionfund.org.uk/Documents/purple_book_2014_chapter1.pdf

product provider regarding the pension itself. Common types of contract-based pensions include group personal pensions and group stakeholder pensions.

Contract based schemes are defined contribution. These aim to build pension 'pots' for retirees which can then either be wholly or partly invested in an annuity or drawdown vehicle. There are reckoned to be more than 100,000 contract based schemes now in operation.

In recent years, defined contribution schemes have overtaken defined benefit schemes as the savings vehicle most commonly offered to new employees. The percentage of employees enrolled in defined benefit schemes has fallen from 46% in 1997 to 28% in 2011²³. The trend for saving into defined contribution rather than defined benefit workplace pension schemes is likely to continue as employers have to carry significantly less liability for pension outcomes. In recent years, a large number of trust based schemes have become hybrid schemes,²⁴ where the defined benefit pensions of former and some current members of staff are managed alongside the defined contribution pensions of newer members of staff.

Insurance companies

Insurers that provide long term savings, pensions and life insurance products need to ensure they meet their long-term liabilities, and they do this by investing the premiums received in different types of investments.

At the end of 2013, the amount invested in insurer-administered occupational pension funds was £520 billion and the amount invested in insurer-administered individual pensions was £550 billion. A further £330bn was invested in life and other business. Money invested in self-administered pensions not administered by insurers was £1,335 billion²⁵.

Open and closed-ended funds offered to both institutional and retail investors

Both open-ended and closed-ended funds comprise a portfolio of securities (such as equities and bonds) managed by an investment manager.

An open-ended fund issues new units, or repurchase old units, as needed to meet investor demand, depending on whether money is being added to the fund or units are being redeemed. The per-unit price is determined by the net value of all assets held by the fund, divided by the number of units.

A closed-ended fund has a fixed number of shares and these are purchased from other investors. Shares sell at either a premium or a discount, depending on demand.

23 ONS statistics on Occupational Pension Schemes: <http://www.ons.gov.uk/ons/rel/pensions/pension-trends/chapter-7--pension-scheme-membership--2014-edition/index.html>

24 According to The Purple Book, prepared by TPR and PPF:

²⁵ Association of British Insurers (ABI) statistics : <https://www.abi.org.uk/Insurance-and-savings/Industry-data/~media/DBDADF2BB9CD4C8B88419CD2B9E37D5E.ashx>

In the UK market, the vast majority of funds under management are in open-ended funds rather than closed-ended funds (otherwise known as Investment Trusts).

According to the Investment Association, in 2013/14 the UK was the second largest investment management centre in the world with around six trillion pounds of assets under management²⁶. Of this total:

- Approximately 60% related to UK investors and 40% to overseas investors.
- 78.5% was managed on behalf of institutional investors, of which:
 - 36.3% was from pension funds.
 - 16.2% was from in-house insurance.
- 21.5% was managed on behalf of individual investors.
- Equities accounted for 46% of total assets but less than a third of this was in UK equities.

Pension scheme size facilitates greater visibility and greater voice

Size and scale are important when considering the ownership chain. Industry experts commented that the very largest pension schemes were at a considerable advantage to smaller schemes in that:

- They have greater negotiating power when dealing with custodians and asset managers.
- They have less need to invest in pooled funds operated by external asset managers for diversification purposes.
- They are less likely to hold assets in omnibus accounts at the level of the custodian and more likely to be able to ask for a segregated account.
- They have greater in-house resource to focus on governance, engagement and voting.

“As responsible institutional investors the Fund seeks to influence companies’ governance arrangements, environmental, human rights and other policies by positive use of shareholder power. The Fund regards its voting rights as an asset and uses them carefully. The Fund has established a set of voting guidelines which cover corporate governance issues and has engaged a third party service provider to ensure that its votes

²⁶ Asset Management in the UK 2013 – 2014:
<http://www.theinvestmentassociation.org/assets/files/research/2014/20140909-IMA2013-2014-AMS.pdf>

are executed in accordance with its policies. Its voting record is published on the Fund's website." (Larger pension fund)

Industry experts told us that smaller funds do not have these economies of scale:

- They have limited negotiating power with asset managers and custodians.
- They are less likely to have in-house investment expertise, and so tend to rely on investment advisers to point them in the direction of suitable asset managers.
- They need to invest in funds which are pooled at the level of the asset manager in order to have sufficient diversification of assets.

Additionally, whilst regulation is in place to cover other activities, there is no compulsion to vote:

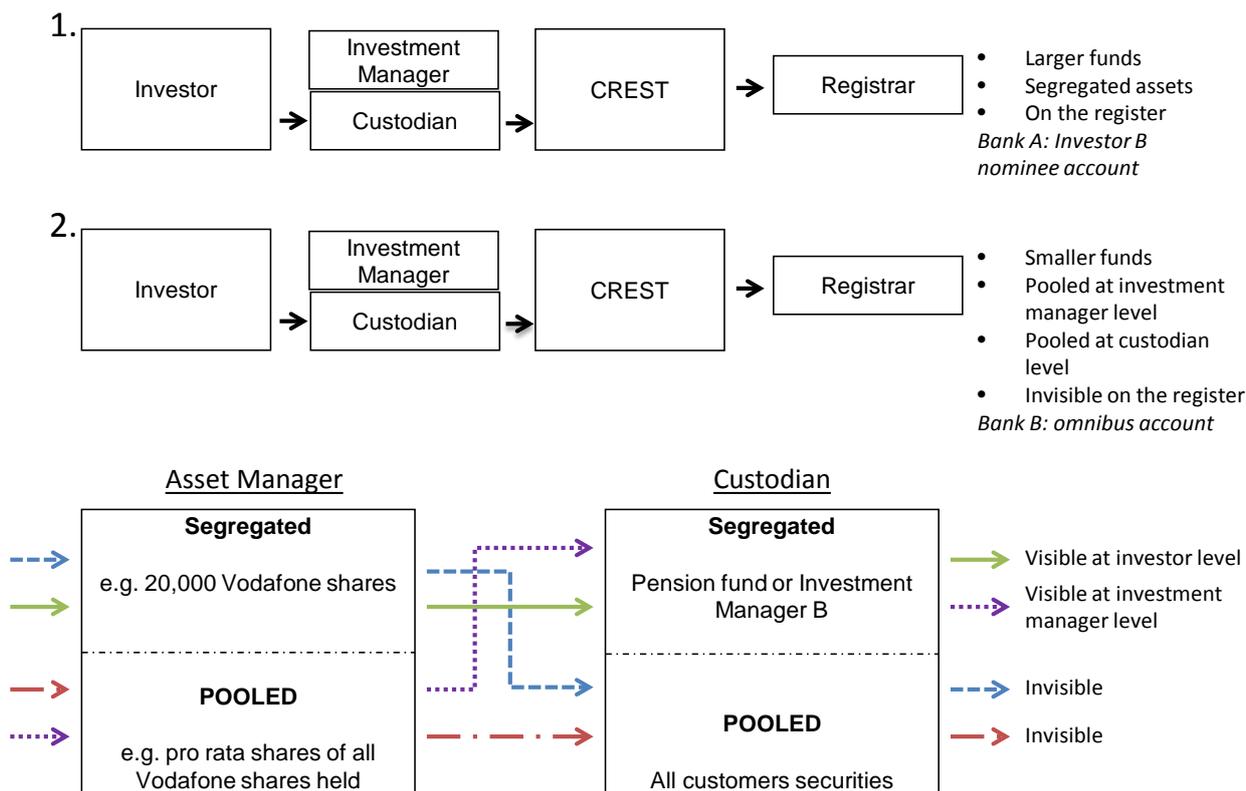
"...I wouldn't say it is a nice to have but if you don't do anything in that area there isn't a legal risk that you are going to get fines" (Smaller pension fund)

Figure 7 offers a simplified view of how shares tend to be held by: 1) larger pension funds; and 2) smaller pension funds.

1. A larger pension fund (£1bn+) is likely to hold its own non-pooled assets in a nominee account at its custodian bank. Here, the investment manager manages the funds, but does not facilitate custody and therefore does not appear in the ownership chain. CREST keeps an aggregate record of all the securities held and the registrars have access to a copy of this record, enabling the company to identify who owns shares through the section 793 process.
2. A smaller pension fund (<£100m) will be more likely to hold all of its funds in pooled assets (collective investments). These assets will be held by a nominee company operated by a custodian for the investment manager and the fund will not be directly visible either to CREST or to the Registrars.

Figure 7: Ownership models for UK shares

Figure 7 illustrates how the investment chain affects the degree to which smaller pension funds and larger investment funds are visible on the register. The identifier on the register is in the form of the name of the custodian bank nominee accounts and any codes used to identify who the investor is. The level of granularity (and therefore the ability to identify a specific institutional investor) depends upon the extent to which assets are pooled at the level of the asset manager (in pooled funds) or at the level of the custodian (in omnibus accounts).



A medium sized pension fund of between £100 million and £1 billion in size may hold a mix of pooled and non-pooled assets, and may therefore employ a mixture of both of these models. In general terms, the smaller the size of the fund, the more likely it is that a higher proportion of assets will be pooled at the level of the investment manager.

The reasons for these different ownership models are to do with economies of scale as well as the need for diversification, which is important with regards to spreading risk.

A smaller fund is very likely to be advised (by its investment advisers) to diversify its assets by investing in as wide a range of asset classes as possible. The most practical, cost-effective method for achieving this is by investing in pooled funds operated by investment managers.

A larger fund has sufficient assets to undertake diversity at a fund level, spreading its assets across a number of different investment managers and getting the investment

manager to manage the funds' assets. A large fund will almost certainly have a proportion of pooled assets within its portfolio, but proportionately much less than a smaller fund.

In summary

For UK shares held by UK institutional investors there are a minimum of four intermediaries in the chain between the beneficial investor (e.g. a pension fund) and the share issuing company:

- An investment manager, who manages these assets on behalf of the fund
- A custodian bank who holds these assets in custody
- CREST, the CSD where the record of these assets is held on a register
- The registrar who holds a record of the investors on behalf of the company

This model only refers to the investment chain and how shares are held. As illustrated below, there are other participants involved in advising on which investment managers are used and in the operation of the voting chain.

Also, this model considerably increases in complexity for non-UK shares and for non-UK institutional investors.

The term, institutional investor, is somewhat of an over-simplification in that it encompasses both beneficial investors (pension funds) and those who manage funds on their behalf (investment managers). A further complication is that in some instances (insurance companies for example), investment managers are part of the same organisation as those administering funds,

The pension fund sector in the UK consists of a relatively small number of very large funds, and a much larger number of relatively small funds.

Very large funds are more likely to hold securities in custody via their own custodian and in accounts that are separate or 'segregated' from those of other investors. This means that their identity is known to the companies they invest in (via the register).

Smaller funds are more likely to hold securities in funds that are pooled at the level of the investment manager, and which may be further pooled at the level of the custodian used by the investment manager.

Intermediaries in the ownership chain

The role of the custodian

Before the introduction of electronic trading, institutional customers needed somewhere to 'store' their paper certificates. Naturally, as banks were already used to hold other liquid assets (cash), the bank vault became the obvious place to store these certificates. However, we were told by industry experts that up until relatively recently (20 years ago), some/ investment managers ran their own custody and even today some stockbrokers act as their own custodian.

Today, in the era of information technology, there is nothing to be 'stored' as such, other than a series of digital authentications. Meanwhile, the role of the custodian has expanded to include a range of other products and services including:

- **Information and accounting services:** Investment accounting, performance measurement and asset liability monitoring
- **'Value added' services (for clients):** including stock lending, derivatives services and currency hedging

"Going back 15/20 years, custody was pretty straightforward. A pension fund needed someone to look after some of their assets or their segregated assets. They also needed someone to collect dividends. They'd need bank accounts for the investment managers (asset managers) that they had to be able to fund their activities, and they needed the custodian to settle trades and deal with things like corporate actions. So custody used to be pretty straightforward. As pension funds themselves became more complex, the services provided by the custodian have become more complex to meet that demand."
(Investment consultant)

There are four very large global custodians which between them account for nearly two thirds of the global custody industry.²⁷

Below this top tier, banks with a more national or regional focus operate as sub-custodians. However, we were told that most institutional investors based in the UK tend to use one of the main global custodians.

As already described, most of the larger pension funds have a direct relationship with a custodian with regard to its non-pooled securities and other assets, whereas funds which are pooled at the level of the investment manager are held by the custodian of the asset manager's choice.

²⁷ <http://www.forbes.com/sites/greatspeculations/2014/08/29/global-custody-banks-continue-to-see-strong-growth-in-asset-base-over-q2/>

At the level of the custodian, assets are held either in:

- Segregated accounts – which contain only the assets of a particular institutional investor
- An omnibus account – where the assets of many institutional investors are pooled together in one account

It has been mentioned already that this pooling of funds at the level of the custodian in omnibus accounts has consequences both in terms of ownership and voting rights, which we discuss in more detail below.

The Role of the investment consultant

Smaller pension schemes have relatively few in-house staff. Instead they rely on advisers, including actuaries and investment consultants.

Defined benefit pension schemes in particular rely heavily on investment consultants. Unlike investment managers, consultants do not pick individual investments. Instead they provide strategic advice to trustees about asset allocation.

Following the actuarial valuation, trustees will agree a figure on the performance required if the fund is to meet its liabilities. The investment consultant then produces a detailed plan of how to achieve this, focusing on how assets should be allocated between asset classes to provide appropriate levels of yield and risk. The investment consultant's advice will be used to construct one or more mandates, which are the instructions the trustees give to their chosen investment managers. The consultant may also organise a "beauty parade" of the different investment managers the trustees may wish to use.

The UK investment consulting market is estimated to be worth around £80 million a year in fees. This compares with an estimated market size for actuarial services of roughly £250 million and an estimated £4.9 billion for institutional fund management.

The four largest investment consultancies in the UK provide investment consultancy in at least 70 per cent of investment reviews for funds with assets of over £25 million.²⁸

The role of the investment manager

Investment managers invest clients' money in a range of asset classes, including equities, bonds and property.

Within an investment manager firm, fund managers research markets and asset classes and make decisions on whether to buy or sell. There are many different types of investment management. Passive managers replicate the performance of an index, while active managers attempt to add value by beating their benchmark index.

²⁸ Section 11.40 of The Law Commission Report into Fiduciary Duties:
http://lawcommission.justice.gov.uk/docs/lc350_fiduciary_duties.pdf

Trading is undertaken via a broker in an investment bank.

Some investment managers either undertake their own stock lending (managed in-house) or arrange for a custodian bank to do this on their behalf.

Whilst investment managers do not own the assets they manage, particularly where funds are pooled and contain the assets of many different institutional and individual investors, they may take on a stewardship role. For example, they may undertake activities such as engagement with companies and voting on shares on behalf of investors.

The UK's fund management industry is the largest in Europe. Assets under management within the industry were reckoned to be £6.2 trillion at the end of 2013. Nearly two-thirds of funds under management (64%) are from institutional clients. Retail clients account for a further 16%, with the remainder accounted for by private client funds and alternative funds.

A number of investment managers are subsidiaries of larger insurers. Other investment managers, act on behalf of a particular large pension fund. There are also investment managers who manage assets on behalf of a collective of similar or like-minded funds e.g. a specialist investment manager for charities, faith organisations, and local authorities.

Investment managers, pension funds and insurers are often lumped together under the collective heading of institutional investors. This can create the illusion that this is one audience sharing similar opinions and objectives when the truth is quite different. In some instances, where the investment manager is a subsidiary of a larger insurer, incentives are often much more closely aligned than when there is no connection (beyond a contractual one) between the beneficial investor and its investment manager.

The role of the registrar

The core role of the registrar is to keep an up to date register of all shareholders.

According to registrars we spoke with, for a large mature PLC the register might comprise two broad components:

- A very long list of names of individual investors holding share certificates or CREST accounts, perhaps accounting for 10% of the value of all shares.
- A much shorter list of nominee accounts representing the holdings of institutional shareholders, accounting for 90% of the value.²⁹

As Figure 7 on page 96 illustrates, with regards to institutional investors, the registrars only have visibility over the top level of the chain. Neither they nor the companies they

²⁹ This shorter list would also include the nominee accounts operated by stockbrokers for retail clients.

represent know who their larger underlying investors are unless enquiries have been made under section 793 of the Companies Act³⁰.

Another key role for the registrar is to collect proxy votes from individuals and institutional investors and pass these to the Chairman of the company prior to an Annual General Meeting, for example. The registrar has to count votes and match them against what appears on the register at a given point in time (e.g. to ensure that a vote on behalf of 1,000 shares ties up with a similar sized holding on the register).

The registrar rarely receives votes directly from an institutional investor. Instead votes are passed to them either directly from a proxy voting adviser or from a proxy voting agent via CREST.

Most companies issuing shares outsource the registrar function to a third party company offering share register administration as part of a wider range of administration services.

The duties of a registrar are important, but we were told by some registrars and by other participants that registrar activity alone is not sustainable as a stand-alone activity. Instead, registrar services are typically bundled with other business and administration services.

The role of Euroclear – the UK’s central securities depository (CSD)

As the UK’s CSD, Euroclear is the operator of the CREST securities settlement system. Unlike traditional CSDs, it does not act as a custodian or depository for the UK and other domestic securities, as it does not hold domestic securities on behalf of participants. It does not extend credit as a bank may do either. Rather, it facilitates the electronic transfer of legal title to securities against cash.

The CREST system employs a ‘direct holding model’ where the owners of those securities hold them in an electronic dematerialised form and receive all shareholder benefits, such as dividends and participation in other corporate actions. Since securities held in the CREST system are dematerialised, they can only be transferred by means of electronic instructions, which are sent to the system across highly secure and resilient networks. This differs to securities held outside of the CREST system, which can only be transferred upon the presentation of a signed stock transfer form to the issuer (or his agent, the registrar).

- Under UK law³¹ the legal ownership of dematerialised securities (electronic shares not physical share certificates) is evidenced by the entries in the electronic register maintained in the CREST system.
- For dematerialised UK securities, the CREST system is (legally) the primary source of information whereas for certificated securities (paper share certificates) the registers operated by registrars are the primary source.

³⁰ http://www.legislation.gov.uk/ukpga/2006/46/pdfs/ukpga_20060046_en.pdf

³¹ The Uncertificated Securities Regulations 2001:
<http://www.legislation.gov.uk/uksi/2001/3755/contents/made>

The CREST system undertakes other activities, including:

- The central messaging point which facilitates direct communications between share issuers, intermediaries and investors. It also allows issuers to instruct payments of dividends to shareholders and facilitates corporate actions and voting for general meetings.
- An electronic transaction confirmation system. When parties to a transaction make a deal, they both electronically confirm their sides of the transaction via electronic transfer. Both parties are required to submit confirmation details to CREST. In the event that transaction details do not match, CREST will highlight the issues to ensure that the problems can be resolved as soon as is practicable.
- A range of collateral management tools to enable CREST members to use securities as collateral for different types of trading activity.

A **CREST member** is the legal owner of the securities appearing through a unique identifier on a register. This member might hold securities for other beneficial shareholders through a pooled or designated nominee. The CREST system currently handles around 25,000 members and 380,000 thousand designations.

Smaller organisations tend to have indirect relationships, sponsored by a Direct Member. This provides them with securities and cash functionalities in the CREST system and allows them to be the legal owner of securities via name on the CREST register.

Euroclear told us that there are a relatively small number (a couple of hundred) of 'Direct Members' who have the hardware and software to enable them to interact directly with CREST using dedicated secure networks for exchanging electronic messaging. These tend to be the banks (custodians), investment houses and larger stockbrokers.

Private individuals (known as CREST Personal members) can be sponsored by a broker and hold accounts directly in the CREST system. This facilitates full legal name on register whilst delivering electronic settlement and allowing private investors to settle on the same time frame as the institutional market (T+2).

Transparency and ownership

Neither Euroclear nor the registrars have visibility over who are the beneficial owners (i.e. the actual economic owners) of shares. However, under company law in the UK, share issuers have a right to find out who are their investors, and there is a formal process for discovery. However this process is not always automated and in some cases still involves formal correspondence via the postal service.

There is no formal process for an institutional investor to discover who the other large investors in a company are. Where investors (institutions or individuals) desire to identify

other investors in order to engage in shareholder activism, or to put forward a shareholder resolution, they cannot rely on the register to provide the details.³²

In summary

Whilst UK company law mandates transparency with regard to institutional investment, the reality is somewhat more opaque.

Custody is largely an administrative function involving secure storage (now in digital format) of assets, the passing on dividends and settling trades. However, a range of products and services has evolved around custody including information services such as performance measurement and stock lending.

At the level of the custodian, funds are either held in segregated accounts (the assets of one institutional investor held separately) or more commonly in pooled omnibus accounts alongside the assets of many other investors.

Just as an individual investor investing in funds might use a financial advisor to help them to decide which funds to invest in, pension funds tend to use investment consultants. These consultants act as intermediaries between the funds and investment managers. They do not manage assets themselves, but they do advise on who manages those assets.

With regard to keeping an up-to-date register of investors, the role is shared between the registrar (who is the primary source for certificated shares) and CREST (the primary source for dematerialised shares). However, neither register provides much visibility or granularity with regard to the beneficial owners of shares.

³² They can inspect the register of interests required under section 808 of the companies act, which details information gained via the 793 discovery process, but only on the assumption that such processes have been undertaken by the company:
<http://www.legislation.gov.uk/ukpga/2006/46/section/808>

Institutional Investor Voting

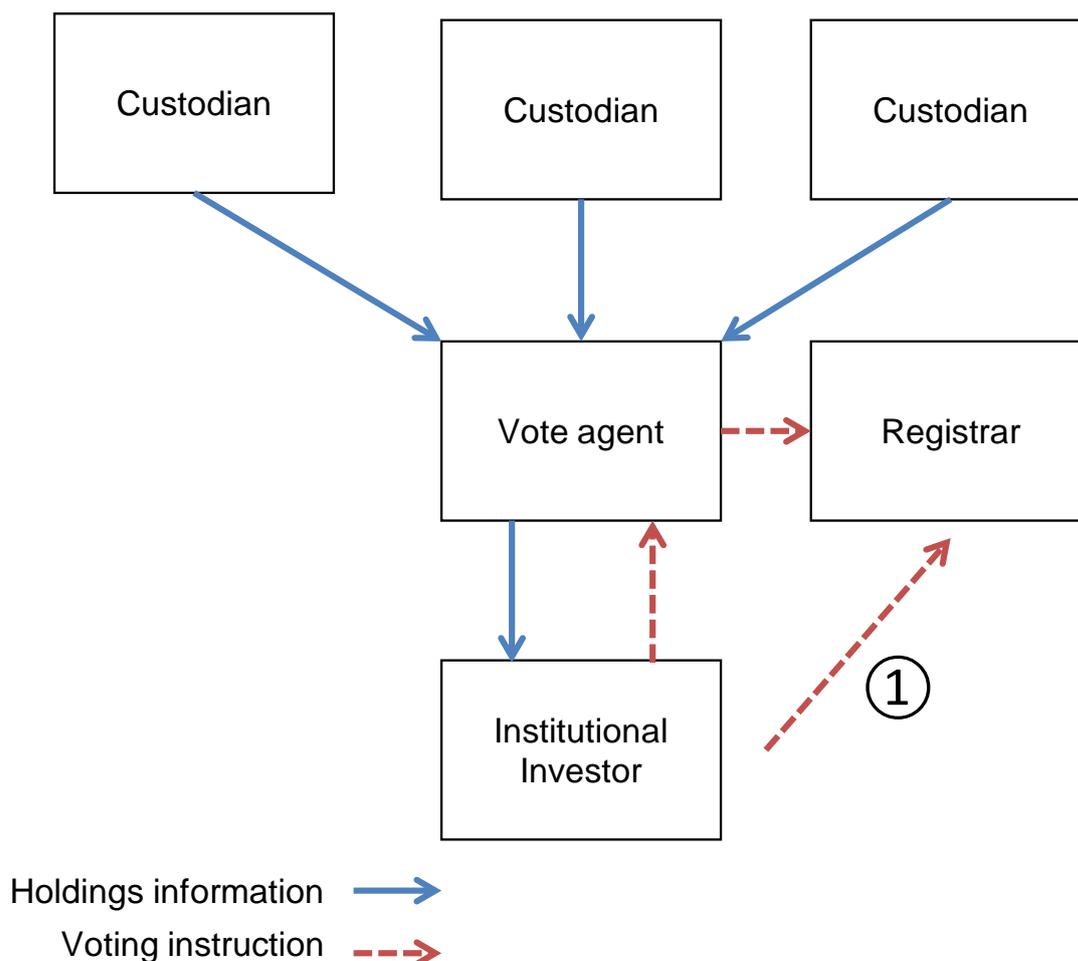
In this section we look specifically at how the voting chain for institutional investors functions and describe the role of additional intermediaries involved in the voting process.

The signal path for voting

At a very simplified level, the signal chain for voting looks like this:

Figure 8: Signal path for voting: a simplified model

Figure 8 illustrates how information on who is eligible to vote and how many shares they are eligible to vote on is passed from custodians to vote agents, who then pass this information to institutional investors to enable them to provide proxy instructions. These instructions are then either passed to the registrar directly or via the vote agent.



The role of the proxy voting agent

Whilst CREST operates infrastructure and messaging services with regard to the ownership of institutional shares, proxy vote agents provide the infrastructure and messaging services associated with voting.

The proxy vote agents work on behalf of custodian banks to provide institutional shareholders with details of upcoming shareholder meetings (creating electronic ballots) and to enable the institutional shareholder to record its proxy vote instruction.

Proxy vote agents act as a conduit between the custodian banks in whose nominee accounts the shares are registered and the institutional shareholders (funds and investment managers) who hold the voting rights.

These instructions are collated by the vote agent on behalf of the custodian banks and are then sent through to the registrar.

Participants told us that in most cases, rather than dealing directly with institutional investors, proxy vote agents communicate via a proxy voting adviser authorised to act on the investor's behalf.

However in theory (see (1) in Figure 10), any party can lodge their proxy votes direct with the registrar. Indeed one of the smaller proxy voting advisers lodges the majority of its votes direct without going via an agent or CREST.

The role of proxy voting advisers

Proxy voting advisers conduct research based on annual and other reports issued by companies, and provide shortened versions of these with commentary, highlighting important areas such as (for example):

- Votes which break governance rules, such as voting for a joint Chairman and CEO or reappointing an auditor beyond a specified number of years.
- Remuneration reports assessed to be too short term in their outlook or perceived to have a danger of rewarding failure.

Each proxy voting adviser operates a somewhat different business model. Most consult with investors and provide bespoke voting policies based on their preferences. Some offer voting recommendations.

Proxy voting advisers also provide electronic platforms and other systems which facilitate institutional investor voting. In most cases, votes are then passed to the proxy vote agent, although at least one proxy voting adviser in the UK passes votes direct to the registrar.

We were told by one participant with experience of working both in an investment management company and a proxy voting adviser that in an environment where institutional investors are expected to vote in a considered manner on all shares held (where possible) and where the voting season is concentrated over a few months a proxy advice agency is an essential service. Indeed, some investment managers and brokers used the services of more than one proxy adviser:

“Trust me, you don't want to be an investment manager having to do everything by yourself - it's just not going to work. To my mind, you need the proxy service industry because it's a massive workload. It's good if they do the first analysis. There are investment managers who will never look at what the proxy adviser provides them; there are investment managers who are so on top of this that they invest a lot of time and resources. Saying that, I don't think there are many investment managers who can afford not to have proxy advisers; it's just impossible.” (Former investment manager)

The proxy advisor market is also highly concentrated. One company based in the USA is by some distance the world's largest proxy voting advisory company, reckoned to hold an 85% share, and another company, also based in the USA is the second largest. According to the European Securities and Markets Authority (ESMA) market shares have not been measured on a UK or European level as yet. However in its 'Overview of the Proxy Advisory Industry'³³ it provides detailed characteristics of advisors and the relative scale of their operations.

How shareholder rights are exercised in practice

As we have seen, shareholder rights in the world of institutional investing are largely determined by where securities are held in custody and the resulting entry on the shareholder register. The name on the register, (e.g. a nominee account with a custodian bank), is the entity with legal entitlement to vote. Naturally, custodians acknowledge that shareholder rights are not 'their property', so they facilitate the passing down of these rights down their client investors. As we have illustrated, this can either be the beneficial investor itself (for a large pension fund or an insurer) or an investment manager holding shares on behalf of a group of investors in pooled funds.

As Figure 9 illustrates, the end to end voting process is something of 'a conversation' between the investor, the investment manager (sometimes) and the custodian. Which participants are involved and who has the loudest 'voice' will depend on the size and scale of the investor involved. We found examples where:

- In the **Investor Centric model**, the largest pension funds will discuss voting with their investment managers, but will vote themselves based on advice from their proxy advisers. Depending on who the adviser is, the path of the vote will either go direct from the adviser to the registrar or via the custodian's proxy agent
 - If the proxy adviser does not use a proxy agent, the proxy adviser is provided with a mandate to receive information regarding assets held in custody
- In the **Investment Advisor Centric model**, for a smaller pension fund invested in pooled funds, their role in the voting process might be quite passive, in that they often delegate this activity to their investment managers, typically by setting out specific instructions or criteria by which they should exercise votes, which might be with reference to recommendations of a proxy voting adviser.

³³

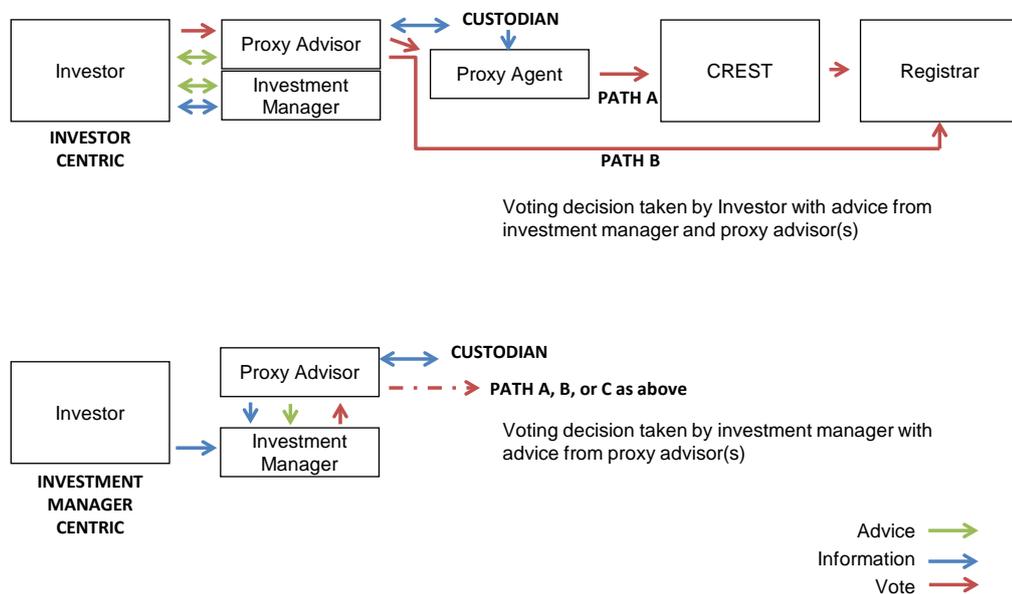
Paragraph 26L <http://www.esma.europa.eu/system/files/2012-212.pdf>

- Voting instructions are then passed via the voting adviser used by the investment manager

Figure 9: Signal paths or advice, information and voting

Figure 9³⁴ provides a more complete description of the ways in which advice and information on voting is provided to institutional investors, and how proxy instructions are passed to the registrar.

A larger pension fund may discuss voting intentions with its investment managers based on information and / or advice provided by a proxy voting adviser. A smaller pension fund may provide information to its investment managers which, dependent upon the contract between the two parties may or may not be factored into voting decisions.



Collective stewardship options

Only the very largest pension funds and asset managers have the manpower and resources to conduct effective corporate governance and voting themselves, and have sufficient ‘voice’ (based on their assets) to influence companies on their own.

Investor representative bodies told us that for those not operating at this scale, there are a variety of options:

- Participation in shareholder action groups.

³⁴ Diagram drawn up based on conversations with various participants in the investment chain

- Collectivism in asset management for like-minded investors - for example, a specialist investment management provider operating a service available to charities, faith organisations, and local authorities.
- Full or partial delegation to other organisations - some investment advisers and other third parties offer stewardship and engagement services.

In summary

In practice, the voting chain was felt by investors and some investment managers to work poorly in that end-to-end confirmation was difficult to achieve.

Large institutional investors were able to arrange to have voting rights passed back to them via the contracts they had with their own custodian banks and investment managers.

Smaller institutional investors in pooled accounts tended not to have such contractual arrangements in place with their investment managers and instead relied on investment managers agreeing to vote proportionately on their behalf; and this may be difficult, particularly if funds are also pooled at the level of the custodian.

Custodians are central to the institutional voting process in that:

- Technically, shareholder rights are determined by where they were held in custody (rather than who the beneficial owner was).
- Collectively, custodians held the most granular source of information as to which institutional investors hold shares at any given point in time.

Institutional voting was facilitated by:

- Proxy voting agents, who facilitated electronic ballots and managed the messaging system infrastructure between institutional investors and registrars on behalf of the custodians.
- Proxy voting advisers, who conducted and produced research on companies in order to help institutional investors make voting decisions, and who provided electronic platforms on which to cast votes.

The market for both of these types of activity was highly concentrated.

Fees Paid by Investors

This section of the report provides an overview of the costs incurred by investors through the chain.

In order to invest in UK equities (or indeed any other asset class) an institutional investor incurs a series of costs. Some of these are mandatory / unavoidable costs and some are optional. The table below summarises the key fee items and then provides additional data on each.

The “bundling” of various services together is a common feature of this market, making it difficult in some instances to unpick the precise charge for one specific service. Additionally, because of the huge variation in size (and negotiating power) of institutional investors, there are no set fees. Contracts between underlying investors, investment managers and custodians are subject to negotiation. So whilst fees are paid on an *ad valorem*³⁵ basis (or a percentage of assets in custody or under management), these percentages are not set in stone.

The following data are based on figures provided confidentially by investors and other participants in the investment chain who we conducted interviews with. It should be noted that figures are based only on a small sample of figures and may not be representative of the overall market.

³⁵

Ad Valorem literally translates as, 'in proportion to the value'

Summary of fees paid by investors

	Basis on which fees are paid	Indicative Fees	Perceived level of transparency?
Mandatory Fees			
Charges for investment advice made by investment consultants	Variety of different fee models including regular 'retainer' fees, hourly consultancy fees, asset based fees (ad valorem) and performance based fees	Where fees charged, hourly consultancy rates in the region of £200 - £300	Advice fee can be opaque – often bundled with other services in an overall fee
Charges for investment management made by investment managers	Ad valorem (% of assets under management)	For UK equities – 20-30 basis points for passive management / pooled funds (custody fees included) and 40-60 basis points for actively managed	Overall charge is a bundled fee for a complex range of services. For example transaction charges are not always explicit.
Charges for custody made by custodians	Ad valorem (% of assets in custody)	1 or 2 basis points for UK equities	Custody fees are set based on the overall relationship which may involve a number of additional functions such as Performance Measurement and stock lending.
Optional Fees			
Performance Measurement fees charged by custodians	Negotiated fee based on size and complexity of assets	c£200,000 per annum for a large fund	Whilst fees are transparent, it is not always clear how they are negotiated based on the overall relationship
Performance fees, charged by investment managers	Negotiated fee – based on fund performance relative to a specified benchmark or benchmarks		We were told by one manager of a larger pension fund that calculations were highly complex and often difficult to understand
Proxy Voting Advice fees charged by proxy voting advisers for reports, recommendations and voting services	Fixed cost based on number of markets covered and/or number of reports	c£30,000 to £40,000 per annum for UK data	Relatively transparent, although platform provision / technical assistance with voting is bundled into the overall cost
Revenue Positive Activities			
Stock Lending, remitted by custodians	Revenue split with custodian	In range between 75:25 and 80:20 (Investor taking majority share)	Relatively transparent and permission based – although % rates are negotiable

Investment advice fees

Desk research uncovered a wide variety of business models amongst the investment consultancy community coupled with a relatively high degree of opacity. We saw examples of:

- Asset based charging (on a percentage or ad valorem basis)
- Consultancy fees charged on an hourly basis
- Typical ranges £200 - £300 per hour, although some charge up to £600
- Fixed 'retainer' fee plus 'project fees'

There also appears to be some flexibility, with one of the larger consultancy firms quoted as being 'happy to work in a variety of ways'.³⁶

Investment management fees

Our research identified that investment managers charged an *ad valorem* fee for their services. In the case of investment manager these fees differed based on:

- The type of asset class and (for securities) the markets involved.
- Whether funds were actively managed or passive (following an index)

All fees were negotiable based on the size of the fund. A larger fund investing more assets would pay a lower percentage fee than a smaller fund. Costs for pooled funds also included the costs of custody for these funds, but this was quite low (see below) and absorbed within overall costs.

Investment managers generally did not split out additional charges on top of their ad valorem fees. Effectively, all of the other services they undertake were 'bundled' into the overall costs.

"If it's passive it could be anything between 15 and 20 basis points. If it's emerging market equities it could be heading into the 30/40 basis points. This is like a diversified growth fund, where you've got lots of different asset classes, and could be anything like 50 basis points, which is still less than half what retail investors pay for investment management services. But then of course, you get things like private equity and hedge funds where you've got a different fee structure in place. Most pension funds, their equities, if they're not passive they're probably in the 30 to 55/60 basis points range". – (investment adviser)

Whether an underlying investor arranges for voting rights to be passed back or allows the investment manager to vote on its behalf appears to make no difference to the fees charged by the investment manager.

³⁶

<http://www.pensions-insight.co.uk/survey-investment-consultants-under-the-spotlight/1466167.article>

In general, investors did not tend to question the need for investment managers or the level of fees paid. There was an acceptance that there are costs associated with fund management and related activities.

However, there was some demand for greater transparency. One large pension fund we spoke with would like to see investment management costs split out (at minimum) by:

- Fixed costs – overheads / the cost of doing business
- Variable costs – transaction costs, research, engagement etc.

This same fund conducted much of its own investment management in-house, with the exception of passive (index tracking) funds which it outsourced to external investment managers. Another larger pension fund we spoke with was considering a return to more in-house investment management.

Custody Fees

It is standard practice for a custodian to charge a composite fee (computed as a basis point charge on market value) to cover safekeeping and the range of asset servicing activities, plus a fee for principal transactions (trade instruction and/or settlement).

Custody fees varied by asset class. Based only on a very small sample of pension funds, the perception that pension funds have was that, whilst notionally there is a menu of basis point charges for each asset class (for example one basis point for UK securities, five basis points for emerging markets securities), these fees were negotiable based on the overall size of the fund.

One pension fund manager candidly suggested that in his experience, custodians have an overall figure in mind in terms of what they expect a client to pay (based on their size and spread of assets) and will then set charges to ensure that this fee is paid.

As with investment management, fees tended to be bundled and there was no explicit charge for voting services:

“Other things are simply absorbed like voting, tax recovery, income, all that is absorbed in the other costs, so it's a fee if you like, a bundle fee. I don't know what we pay for the voting? ... buried in the private management accounts of the custodian.” (Pension Fund)

Another experienced pension fund manager objected to paying a percentage fee (ad valorem) for a service that he did not perceive to be ‘value-add’:

“They don't do anything to add to the value. A fund manager might, but the majority of the job is simply to hold the stock for certain timelines to collect the interest/income and recover tax from our own tax authorities. They're not actually creating value. That is a service, but it's not the same as an investment manager who might well add to the value, so why should the custodian benefit from the underlying rise in that asset?” (Pension Fund)

Proxy Voting Advice Fees

We were quoted figures from one of the larger pension funds of around £30,000 per annum for the cost of reports and voting, and additional fees where they pay for a dedicated member of staff during the reporting season.

Performance Measurement Fees

Performance measurement involves analysis of all of client assets and assessing how these have performed relative to industry benchmarks. Fees were charged by custodians dependent on the amount of work required which may vary dependent on the size and complexity of the fund. For a larger fund fees ran into the hundreds of thousands of pounds.

Stock Lending

Stock lending is revenue positive for the institutional investor. Where there was a direct relationship with the end investor there was normally a split in favour of the investor (e.g. 80:20) on revenues generated.

There was less clarity in instances where stock lending generated income for an investment manager. Participants suggested that some investment managers were more transparent than others with their investors in regard to how income was returned to the fund and whether any commissions are deducted.

Commentary on Fees Paid

We should caveat this section by saying that this research was not designed to deliver a full cost benefit analysis. Fees were generally on a contractual basis and were commercially sensitive. Also some of those participants we spoke to were involved in stewardship roles at investment manager companies and were not directly involved in fee negotiations with clients.

However, some consistent themes emerged. There appeared to be a considerable degree of bundling of fees across the investment chain. In part, this seemed more due to convenience and simplification than anything else; it is simple for a pension fund to think in terms of a single ad valorem fee for fund management.

Custody is an activity which some participants argued was anachronistic. Participants had the impression that custodians negotiated fees on the basis of an overall 'cost of relationship' rather than the cost of individual items.

Fee structures in the institutional investment chain were not clear cut. There was bundling and opacity in relation to (for example) investment management. Some fee structures such as performance fees charged by investment managers to a pension fund were impenetrably complex.

Some funds openly questioned the extent to which custody fees, which were mandatory within the current structures and charged on a percentage basis, were justified. It was felt that custody did not add value and was somewhat anachronistic under dematerialisation.

The costs of custody and administration involved in nominee accounts were often passed on by brokers to customers in the form of an annual charge or monthly account management charge based on a percentage of the value of the portfolio. There was a wide range of fees for execution only servicing with some of the larger portals making no charge and some of the stockbrokers charging a fixed percentage charge (up to .02% of total value), but often capped at a particular figure (e.g. £100 maximum charge). Individual investors tended to be more focussed on transaction charges (often stated in cash terms rather than a percentage) and accepted custody and administration charges as a 'relationship cost'.

The costs of investment management were by some way the largest element for a beneficial investor. One pension fund manager estimated that this accounted for 95% of overall costs to the fund. Investment management could be regarded as a form of brokerage, but where there was no clear delineation between administration costs, costs for 'advice' (fund management related activity) and transaction costs. Arguably this allowed for a premium to be placed on the more intangible elements.

Perceptions of the Investment Chain

This section of the report focuses on what participants said about the investment ownership chain and the way in which the structure of the chain influences voting and engagement.

Understanding the chains and reporting the opinions of participants

The ownership and voting chains are highly complex. It was necessary for the research team to speak to participants and read a considerable number of published reports, including those by Professor Kay³⁷ and the Law Commission³⁸ in order to have sufficient grasp of the subject matter and to be able to place the opinions of participants in context.

Many of those we spoke to were either directly involved in consultations around the voting chain (either via the Shareholder Voter Working Group or through PRI) or else were reached via these individuals. Amongst those we spoke with, there was a very strong consensus regarding the dysfunction of the voting chain and also a general consensus that this was a symptom of the ownership chain; although only a lower proportion suggested that root and branch reform of the ownership chain was required. Whilst this research focussed on UK investors and UK companies, we were told by a number of participants that the chains of ownership and voting were much more complicated and problematic with regard to investing in equities in other markets and indeed for overseas investors investing in UK equities.

These findings are based on qualitative research; the opinions of individuals. We cannot assert that these opinions are representative of the institutional investment and intermediary community as a whole. All we can say is that the views and opinions expressed do exist within this community and amongst the published academic literature which is cited in this document below.

Does the ownership chain deliver value for investors?

A key objective of the research was to examine the degree to which the chain of intermediation added value to share issuers and investors, based on the fees paid.

Value is difficult to define. However, arguably the processes which have detached investors from ownership in their shares have led to a growth in intermediation and have increased overall costs to investors.

As is illustrated in Figure 7 on page 96 at custodian level, the use of segregated or omnibus pooled accounts determines the degree to which ownership of assets is visible to

³⁷ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/253454/bis-12-917-kay-review-of-equity-markets-final-report.pdf

³⁸ http://www.lawcom.gov.uk/wp-content/uploads/2015/03/lc350_fiduciary_duties.pdf

CREST and the registrar (and consequently provide a legal certainty over ownership) or not visible outside of the custodian (and where, consequently ownership is derived, as the Law Commission puts it, 'as a series of trusts').

Academics in the field we spoke to were keen to point out that current structures for share ownership in the UK (and elsewhere) are predicated upon the location of assets rather than who 'owns' the assets, and are highly anachronistic in that they refer back to a time when there was something tangible (piles of paper share certificates) in the bank vaults.

At the time of writing, the 'vault' was simply a system of secure servers of a similar type operated by institutional investors themselves. What exists within the vault is an electronic 'token'; a representation of the value of securities. But because the name on the register denotes 'ownership', institutional shares are nominally 'owned' by these nominee accounts that sit within custodian banks. Effectively, institutional investors have 'economic rights' over the shares they purchase, but they do not technically own them.

One academic suggested that over time intermediaries have developed a whole suite of products and services which exploit this location-ownership paradigm:

- Banks have developed a business model around 'custody' which facilitates stock-lending, derivatives and other services
- Brokers and Asset Managers have been able to lock investors in by 'holding' their securities in their own nominee accounts
- Voting agents have evolved to supply connectivity in and out of the chain

The only *participants* in the chain that we spoke with who truly questioned both the nature of the ownership chain and (implicitly) the value of the chain were those who had, during their careers, worked in different 'links' of the chain (for example, as an investor and an asset manager).

"The problem for capitalism then is that what you really want is the intermediaries efficiently and effectively allocating capital to the benefit of the system overall. What we have are people who float above it, drawing rent without contributing. What we need is the professionalisation of the industry, which means that they recognise they have an asymmetry of information and they undertake to look after their clients' interests in return for earning more than they would otherwise..." (Investment manager)

Others who have been in the industry for decades, and who have seen the evolution of the chain of intermediation, are now starting to question the value of the chain:

"It was once wholly in-house long before I joined in 1990. It was all managed in-house up until about 1986, say 30 years ago, and they said, 'Well, maybe it would be best to contract it all out', and so they fired the internal fund management teams and farmed it out to external investment managers and over the next 25 to 30 years the number of mandates grew enormously, and now we are slowly moving back to some in-house (management)." (Experienced pension fund manager)

Academic criticisms of the ownership chain

There is considerable criticism of the ownership chain from non-participants in the chain; academic and legal experts, including Professor Kay, The Law Commission, Dr. Eva Micheler of the LSE and Dr David Donald of the Chinese University of Hong Kong.

The Kay review suggests that market effectiveness should be viewed through the eyes of investors and companies rather than intermediaries:

The growth of intermediation has led to increased costs for investors, an increased potential for misaligned incentives and a tendency to view market effectiveness through the eyes of intermediaries rather than companies or end investors. (The Kay Review of UK Equity Markets and Long Term Decision Making)³⁹

The Law Commission highlights the practical advantages of intermediation, but also illustrates some of the risks and suggests that voting and stewardship is made more difficult:

Intermediation offers practical advantages to both issuers and investors. Recording investors' interests in securities electronically in the computerised accounts of an intermediary allows for greater transferability, which in turn enhances liquidity and consequently the value of the securities. It is also administratively convenient: an investor can hold their entire international portfolio through a single intermediary, without having to bear the administrative burden of establishing and maintaining links with issuers and other intermediaries in different settlement systems.

A dematerialised and intermediated system of securities settlement does, however, introduce risks. If any party in the intermediated tier fraudulently dissipates securities held on its client's account and then becomes insolvent, the end-investor will lose their holdings. It also makes it more difficult for investors to exercise their voting rights, which discourages stewardship activities.⁴⁰ (The Law Commission report into Fiduciary Duties of Investment Intermediaries)

Dr. Eva Micheler goes somewhat further, suggesting structural reform is necessary and should be discussed at government and policy level and not by intermediaries with a vested interest in the status quo:

The starting point towards a solution reducing the cost and uncertainties arising out of intermediation has to be that the number of intermediaries needs to be reduced and also that a direct connection between issuers and intermediaries has to be created. Having determined that there are significant limits to how much harmonization can be achieved at a functional level, it is worth asking if it is possible to create a system which reduces the

³⁹ See Executive Summary, point x:
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/253454/bis-12-917-kay-review-of-equity-markets-final-report.pdf

⁴⁰ See Chapter 11, conclusions paragraph 11:141 http://www.lawcom.gov.uk/wp-content/uploads/2015/03/lc350_fiduciary_duties.pdf

number of intermediaries operating between issuers and investors and also enables investors to directly connect with issuers.

It is important to discuss law, but it seems that this discussion is futile unless it is accompanied by a discussion about structural reform. It is worth asking the question about what would happen if a settlement mechanism was created from scratch using modern means of technology and communication. This is a question best discussed at an academic and government policy level rather than in consultation with organizations that have a vested interest in preserving the status quo. (Intermediated Securities and Legal Certainty, Dr Eva Micheler of the LSE Law faculty.⁴¹

Dr. David Donald suggests that disintermediation would likely bring about innovation and greater choice for investors:

There is also the question of competition. Imagine if the various national monopolies for telecommunication services had never ended. Would we have enjoyed the explosive innovation in voice and data services we saw over the last 20 years? If securities were to exist electronically only on the register of the issuer, no security holder would be tied by force majeure to an intermediary: as happened in the telecommunications industry during the last decades of the 20th century, customers would be free to change broker or bank for different sorts of transactions, depending on the price, expertise and quality of service. This would significantly lower entry barriers and trigger significant price and quality competition in brokerage services. (Heart of Darkness: The Problem at the Core of the US Proxy System and Its Solution, Professor David C Donald, Law Faculty of Chinese University of Hong Kong)⁴²

The majority of other industry participants admitted to having a limited view of the chains of ownership or voting outside of the points to which their roles connect directly. Most had not given much thought as to whether or how these chains were fit for purpose.

Strategies for gaining access to shareholder rights

As already reported individual investors holding share certificates automatically receive shareholder rights. Individual investors who hold their shares via a broker and beneficial institutional investors whose assets are held in custody and managed by investment managers have to arrange for shareholder rights to be passed back to them if they want to exercise them.

The largest beneficial institutional investors (larger pension funds, sovereign wealth funds) had their own custody arrangements and ensured that their mandates with custodians and investment managers specified that rights were passed back.

⁴¹ See Section E: What would work? Section F: Target 2 Securities.
http://www.lse.ac.uk/collections/law/wps/WPS2014-03_Micheler.pdf

⁴² http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1697606

For smaller pension funds that are only invested in pooled funds, there are a number of options to ensure that their 'voice' is heard: proportional voting or supplying additional research to the investment manager.

Proportional voting

One option is to arrange with their investment manager to be able to vote proportionately on the shares held. Some investment managers were more amenable to this than others. We were told that some smaller pension managers had been told that they were so small that their votes are of little consequence and that others had been told that proportional voting was either not within the terms of their investment mandate or else was not possible as funds were pooled at the level of the custodian.

Principles for Responsible Investment (PRI) suggested when we interviewed them that amongst small pension funds, only about one in ten had contracts with investment managers that contained any reference to shareholder rights or proportional voting.

From the investment manager perspective, where an investor requests proportional voting they have to negotiate under their terms of contract with their custodian (which may or may not be explicit around voting on pooled funds). This may be even more difficult if these assets are also pooled at the level of the custodian in an omnibus account.

One legal expert commented that:

- If there is nothing in the contract between an investment manager and a pension trustee, the asset manager has to follow voting instructions, under the Pensions Act 2004 ss241-243).
- In the event that an investment manager sought to exclude the rights of the investor or charge them for exercising the right to vote, the Unfair Contract Terms Act of 1977 would regulate this situation.⁴³

Supplying additional research to the investment manager

Another option for pension funds invested in pooled funds at the level of the investment manager is to arrange with their investment managers to supplement their own research in the area of stewardship and governance.

The National Employment Savings Trust (NEST - the workplace pension scheme) selects for securities where the vote is likely to be contentious. The investment manager then sends an email stating how they intend to vote. Where there is a difference in how NEST would vote, they put together an intelligence pack stating the reasons why they would vote

⁴³ The purpose of this legislation is to ensure that 'freedom of contract' or the 'free market' is underpinned rules when the reality is that one party is not nearly as 'free' as the other: when one party has much less bargaining power, and the other side can offer a deal on unfair terms and say 'take it or leave it'. In any contract, an exclusion or limitation of implied duties (i.e. the duty to follow voting instructions) in a contract could be void under section 3. of the UCT Regulations

differently and then send this information to the fund manager. The investment managers then vote with NEST's opinion in mind, but make the final decision.

Another route for smaller funds is some form of collective action, either formally by paying to become part of an equity ownership collective, or informally with other investors who share similar aims and objectives.

Collective voting instructions

The Association of Member Nominated Trustees (AMNT) researched the current situation with regards to proportional voting and noted reluctance amongst investment managers to let smaller pension schemes vote on pooled funds. As a response, they devised a new concept entitled 'Red Line Voting'. The concept, announced in March 2014⁴⁴, will involve a collective of smaller funds agreeing to a common set of instructions on voting based on Environmental, Social and Governance issues. This should make it easier for an investment manager to administrate (dealing with one larger mandate rather than many smaller ones) and should enable smaller funds to have a collective 'voice'.

Investment managers felt that they should be able to vote on behalf of investors

The investment managers we spoke with largely feel that voting should be delegated to them in that:

- The investor is paying them to 'manage' their shares.
- They are already engaging with companies as part of their fund management activity, so it makes sense that voting is part of this process.
- They have greater resources than most investors and superior research and knowledge.

"We're being asked to run the money, pick and choose the stocks, so I always find it slightly odd that an asset owner then says, 'You carry on doing that but we're going to do the voting. We're going to tell you how to vote.'" (Investment manager)

Some investment managers operated clear in-house policies for voting and governance and communicated these towards investors as 'part of the offer'. In other words, if the investor decided to use a particular manager, then they also elected to subscribe to its voting policy.

The investment manager rationale is that as they have to invest a lot of resource in updating their policies, monitoring companies, engagement and submitting votes, then investors should let them conduct this activity for them, rather than try and influence voting themselves.

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http://amnt.org/wp-content/uploads/2015/05/RLVI_AMNT-press-release.pdf

One investment adviser frankly conceded that the person responsible for voting and governance within an investment manager company used to be regarded by colleagues as someone of low importance, but suggested that this had changed over time. We were told by a number of investment managers that with the introduction of the Stewardship Code⁴⁵, voting and engagement were gaining a higher profile within their organisations and that there was increasing pressure on investment managers to be seen to be undertaking this activity well.

The larger investment managers felt that they had the necessary 'voice' to bring change on environmental, social and governance (ESG) issues. One example provided to us was of a company that was planning to commence operations in an area of outstanding natural beauty in a developing country. In this instance the investment manager (acting with others) had been able to convince the company that this activity would likely have created a public relations disaster in the medium term and may well have damaged the credibility of the business longer term.

But the views of investors may be different

Investors may hold different views from investment managers in important areas such as remuneration policy.

"We take a stricter approach on remuneration. We're also more sympathetic to environmentally and socially motivated shareholder resolutions. We have strong governance views as well. Some of our asset managers may have the same holdings but may be voting in different ways for the same holdings, if they have a different house view" (large pension fund)

Some of the investment managers who participated in this research felt that they were able to take a longer term view of stewardship and were able to build up relationships with companies over a long period. However a contrary view was provided by one sovereign wealth fund manager:

"Our external investment managers may come and go. If they don't perform well enough we fire them, we get another one in'. So actually their perspective is shorter term than our perspective and we want our voting decisions to be strictly over a long-term perspective. So that's why we recognise that our interests as far as the voting rights are concerned are detached from the fund managers' interests as investment decision-makers." (Sovereign wealth fund)

One participant suggested that investment managers had a difficult path to tread with regards to stewardship as it was nowhere near as high profile and significant for them as fund performance, on which they were measured by both investors and by the industry in general:

⁴⁵ The Financial Reporting Council 2012: <https://www.frc.org.uk/getattachment/e2db042e-120b-4e4e-bdc7-d540923533a6/UK-Stewardship-Code-September-2012.aspx>

“If you look at investment fund comparison sites, it's a purely mathematical comparison. There's nothing about how they engaged really nicely or that they have really nice reporting. It's not something that comes out there.” – (ethical investor group)

Possible conflicts of interest

Investors, academic experts we spoke with and other intermediaries perceived conflicts of interest for investment managers which they believed influence voting behaviour. There was no suggestion of wrongdoing or of intentional behaviour amongst investment managers. Rather it was that the issues were systemic, in that they had voting rights over ‘other people’s money’ and were in a position to use votes in order to further their own financial interests.

- They might be reluctant to vote against directors that they rely upon to supply information.
- They might be reluctant to vote against remuneration policies on the basis that they are too high or too short term, perhaps because their own remuneration is assessed on the same basis.
- That voting rights could be used openly, or more realistically, engagement behind the scenes could be backed by voting power to get corporations to e.g. abandon defined benefit schemes in favour of defined contribution schemes.
- That often the larger investment manager firms are subsidiaries of insurers where companies invested in are also their clients.
- They might fear that voting in an ‘ethical’ way might adversely affect share price movements

“Investment managers are very worried about voting against management. That goes back to the third reason why there's no real business model for the fund managers to do this (voting) and that is they're in the business of gathering information to make a better trading decision to buy or sell the shares. If you want to get information out of a chairman - well, more likely chief executive or finance director - you're very unlikely to want to vote against them particularly on matters that relate to their remuneration or views and strategy or whatever.” (Investment adviser)

“Fund managers are paid to outperform an index generally over a relatively short-term period. So they tend not to be interested in the governance of companies' long-term risk management and they tend not to be able to pay much attention to the voting of the shares. So it's turned into a bit of a compliance exercise in many places; they tick the box. This is very minimally resourced relative to the amount of resource that goes into the buying and selling of shares, which of course is very expensive in many cases. So you'll find that while most funds or fund managers would spend a fraction of a basis point so a fraction of a hundredth of one per cent of the value of the funds on this activity, they would quite happily spend multiples of that on buying and selling the shares.” (Investment adviser)

Many of the industry participants we spoke with (including some of the investment managers) were agnostic with regards to who should undertake stewardship as long as it was done well by someone. There was also a widespread belief that where an investor had the desire and the resources to vote they should be able to do so.

Barriers to Better Proxy Voting

This section of the report focuses on the issues that participants feel affect the voting chain, and what is being done to resolve these issues.

Problems with the voting chain

“(The voting chain) serves to illustrate the degree to which regulators and intermediaries have found it necessary to bend the system around a series of redundant paper prioritised processes” (proxy voting adviser)

When discussing the voting chain with participants, almost all began by highlighting what they saw as the most obvious flaws:

- It is very difficult, impossible in some cases, for an institutional investor to attain confirmation that their votes have been cast; which is regarded as a governance issue.
- The lack of perceived accuracy and ‘integrity’ (in the technical sense) of the process.
- The difficulties with organising collective voting and introducing shareholder resolutions.
- Herd behaviour in institutional proxy voting.

At the time of writing, there was no Straight Through Processing (STP) in the proxy voting process designed to address the outcome of votes at the meeting. Were such a solution to be in place it would be possible to trace voting instructions through the chain from the investor through to the meeting at which they were cast. It would then be possible for the investor to confirm that its votes had been cast, and it would be also possible for the company to have greater clarity and granularity over how its investors had voted. One respondent in the investment management industry expressed disbelief that, more than ten years after the Myners Report⁴⁶ there was no STP solution in place.

Why proxy voting confirmation is important

We heard an anecdote from another investment manager which clearly illustrated why voting confirmation can be critically important:

There was a vote to extend an investment company’s life and this was something that the investment manager did not want to happen and wanted to vote against. This was an

⁴⁶ Review of the impediments to voting UK shares - Report by Paul Myners to the Shareholder Voting Working Group January 2004
http://www.shareholdercoalition.com/sites/default/files/Myners%20Report%201-04_0.pdf

infrastructure fund where they were one of the largest investors, and so the vote was materially significant.

He instructed his voting adviser to place an 'oppose' vote and then called the company registrar to ensure that the vote had come through. However, the registrar had no record of receiving this vote. It turned out that the custodian's voting agent were pooling all of the votes in order to release them at a certain point before the meeting. At this point, the investment manager called the registrar again to confirm receipt of his vote. Whilst he was able to supply all of the account numbers, the registrar was unable to confirm whether votes had been received in respect of these account numbers. Instead, they were only able to confirm that a voter with the same number of shares had voted to oppose. The investment manager felt strongly that this was simply not good enough.

We are living on a hope and a prayer that things go through and taking that one example that if it was any other environment you would be sending a piece of paper and you'd send it registered delivery.

It seems ridiculous that you can't get that kind of registered delivery for votes that could materially change the way a company is managed."

This anecdote also illustrates that not all proxy voting activity relates to FTSE 250 companies. Sometimes voting relates to smaller public companies and trusts, where a failure in the voting chain could result in a different voting outcome.

Whilst beneficial investors in many instances have quite low awareness of the machinations of the voting chain, they are aware that it is difficult, often impossible to be able to state categorically that their votes have been received and cast.

Another participant working in a governance function at an investment management company told us that he was frequently embarrassed in a situation where he had to tell an investor that he had voted on the investor's behalf, but had no record or proof that these votes had been cast.

A third investment manager suggested that although institutional investors increasingly reported how they vote, such reports were meaningless unless there was confirmation that these votes were actually cast at the meeting.

"The complexity gets introduced because of the invisibility of the underlying investor to the company because you have this huge cloud of opacity sitting in the middle created by the custodial structure. We therefore have the voting pipe work that gets around that and allows the votes to flow, but the companies don't get more visibility through that. They just get what comes out at the end of the pipe which is clouded with that same opacity."
(Investment manager)

Participants highlighted a number of their perceptions as to why vote confirmation was difficult to achieve and these appeared interrelated.

Opacity in the ownership chain; and consequently the voting chain

Opacity was exacerbated by omnibus pooling at the level of the custodian

An ‘anachronistic’ set of rules regarding record dates, felt by some to cause delays and bundling of votes in the chain

The absence of a universally applied formal end point where all proxy votes are cast

‘Clouds of opacity’ in the ownership and voting chains

As aforementioned, neither CREST nor the company has clear visibility over either whom the investor is, or who has voted on their behalf.

“So you’ve got an institutional investor that says, ‘Right, I want you to vote.’ That goes on up the chain. That instruction gets collated with the instructions of some of the other thousand. And then one collective vote gets lodged with us on behalf of the issuer. Of course you’ve then got one of those thousand saying, ‘I want confirmation that mine was included.’ Without a complete and utter transparency of everything in the chain, right up to the top, that’s a hard reconciliation process to do.” (A registrar)

“We may not know who that end client is because, as you say, there will be code associated with that particular account. We only really know the people who we have the direct contractual relationships with, who are the users and the participants and if they’re providing further services to other clients we may or may not know who they are.” (Euroclear)

When speaking to vote agents (based in the United States), it is only too apparent the importance that is placed on privacy in that market. We were told that a significant problem with voter confirmation was that many investors do not want to be identified.

A UK based investment manager told us that he had once been heavily criticised by colleagues in the USA for suggesting that the OBO/NOBO⁴⁷ system simply resulted in an asymmetry of information which was not good for the market in general.

This individual highlighted this ‘clash of cultures’; between the global custodian banks and vote agents who are all based in the US where investor privacy is a significant factor in the structure of the market and the UK market where share ownership falls under company law and requires at least partial transparency (via discovery), as significant in mitigating against progress towards vote confirmation.

Omnibus accounts are convenient, but not transparent

As illustrated in Figure 7 on page 96 of this report, where a custodian operated segregated accounts there was a degree of visibility: at least the specific nominee company acting as account holder (for the investment manager or larger beneficial investor) was identifiable

⁴⁷ In the USA, Objecting Beneficial Owners (OBOs) are permitted to keep their investments confidential from anyone other than the intermediary with whom they deal directly, including the share issuer (unless they hold more than 5% of capital).

on the register. However, where omnibus pooled accounts were operated by a custodian there was much less visibility.

We were told that a custodian bank might prefer to operate omnibus accounts for the following reasons:

- Simplicity and convenience; it is easier for the custodian to internalise trades and to net trades between clients.
- This involves less internal messaging for the custodian and also fewer contacts between the custodian and the CSD or CSDs.
- It provides a very large pool of assets for the purposes of stock lending and other revenue generating activities (although these activities are also undertaken by banks that don't employ an omnibus structure).

Whilst offering these benefits a number of those we spoke with felt that omnibus accounts were also a key obstacle in the way of greater transparency.

"I don't really realistically see why there is value-add from that (omnibus accounts) apart from the convenience to the custodian and that convenience is partly things like stock lending. They can just do it over a big pool and partly things like cross trades you can just do it simply within the same pool and very little moves on the surface but lots of stuff is happening underneath. If everybody was in a segregated account then we'd be back to that situation where people will be entirely visible to the companies" (investment manager)

Participants also referenced transparency in terms of **security and safety**.

Regulators such as the FCA require firms to keep entity-specific records and accounts. Entity-specific records and accounts are important in the event of an insolvency as they can be used by an Insolvency Practitioner to identify those clients whose assets are safeguarded and are due to be returned. In the recent past, heavy fines have been levied against custodians for failures in respect of adequately keeping records

The ability to internalise settlement of trades was referred to by a number of those we spoke with. There was a suspicion that this allowed the banks to settle any potential errors or discrepancies (for example around dividend payments) at an aggregate level and that there was a lack of transparency in this area.

"They would probably deny it, but they can use Peter's to settle Paul's transactions."
(Investment manager)

Other issues identified related to omnibus accounts

We were told that where there was a failure of a market participant there was also greater clarity around ownership of assets where segregated accounts exist. Apparently, in the collapse of Lehmann's, it was easier and quicker for clients with funds held in segregated accounts to reclaim their assets.

Others were critical of omnibus accounts in so far as they regarded them as ‘redundant architecture’ designed originally to deal with vast volumes of paper, but no longer fit for purpose in a digital age where information flows are faster and more secure.

Where omnibus accounts were operated it was easier for the custodian to integrate its systems with one provider and to generate ‘one file’ which broke down the ownership of all shares held in a particular company at any point in time. One participant in the proxy voting industry felt that the use of omnibus accounts discriminated against its business model, in that custodians would not facilitate direct voting on shares held in omnibus accounts other than via their preferred proxy voting agent.

The direction of travel in Europe is away from omnibus accounts

At European level, regulators have ruled that custodian banks must offer the option of segregated accounts to its direct clients, but this requirement does not operate at other levels of the chain and regulators have not insisted upon mandatory account segregation.

An increase in segregated accounts would generate a greater volume of voting messages and would certainly increase the number of names on shareholder registers (a considerable increase in transparency, but some increase in administration cost), but participants argued that there would also be downward pressure on transmission and administration costs should volumes increase. Euroclear told us that their charges were based on infrastructure costs rather than a ‘cost per message’. In other words, should there be an increase in messages through the system the cost per message would decrease proportionately.

In terms of costs for investors, on a case by case basis, it appears that (at least for a larger investor) there is no premium in custody costs for a segregated account. However, it is thought that smaller funds (less than £100m) might find it more difficult to obtain a segregated account from a custodian. Also, one participant had investigated the possibility of transferring assets from an omnibus account into a segregated account and was deterred by an email detailing the fees for this.

A number of participants commented that one might assume in this digital age it would be perfectly possible for both custodians and investment managers to provide much greater visibility over who owns what. One academic we spoke to suggested that this information could be centralised at CREST level, with one ‘end of trading day’ view for share issuers, another view for investment managers and brokers (detailing their customers) and another view for investors (detailing their holdings).

The issue of record dates

Under the Uncertificated Securities Regulations 2001⁴⁸, the record date for entitlement to vote is struck no more than forty eight hours before the meeting. This is the point at which ‘the music stops’, where whoever happens to be holding shares for a particular company

⁴⁸ See Part 5, Paragraph 41; <http://www.legislation.gov.uk/ukdsi/2001/0110387449/contents>

(whether held for years, just bought or borrowed via stock lending) has the right to vote on those shares.

For historical reasons the record date for voting is also forty-eight hours before the meeting.

It would be impossible to provide information to shareholders about voting and then expect them to vote instantaneously. In practice shareholders are informed (via the proxy voting chain) of their 'likely' voting rights, based on how many shares are held a few weeks prior to the record date, and then asked to provide their proxy votes based on this estimate.

When the record date itself arrives, the voting agent needs to reconcile the proxy votes in its systems with the actual number of shares held by each voter at that point in time (based on information supplied by the custodian).

For reasons of convenience, the voting agents prefer to wait until the last moment before passing the votes via CREST through to the registrar in bundled form.

This way of working presents yet more opacity (as well as the potential for inaccuracy as we examine below):

- An institutional investor is unable to check whether proxy votes have been received by the registrar prior to the meeting.
- If there is any discrepancy between the register and the votes received, the registrar has very little time to rectify this with the vote agent, presenting a risk that votes will not be cast.

The absence of a formal end point

One role of the Chairman is to cast the proxy votes received from the registrar at the meeting. At the AGM of a large PLC, the proxy votes are often displayed on a screen so that those attending can see the results.

Under certain circumstances, the Chairman can ask for a show of hands in the room. For a smaller company, where most of the shareholders are present this can be quicker and more convenient than looking at proxy votes that have been cast.

One of the largest institutional investors we spoke with saw the lack of a defined 'end point' to the proxy voting chain and the continued existence of poll voting as structural weaknesses. Under common law, the Chairman must confirm that votes have been cast at the meeting, but can still do this without formally converting all proxy instructions into 'votes cast'. This presents a barrier to a universally accepted and applied system of vote confirmation.

It should be noted that the issues surrounding show of hands voting are highly emotive: we were told that individual shareholders who attend AGMs felt strongly that their voice (however small) should be heard at the meeting. One shareholder association representative we spoke with was enraged that at one AGM he was one of thousands waiting for the opportunity to raise their hands against a motion but (he felt) denied this

opportunity by the Chairman who simply read out the proxy vote. Equally, one of the investment managers we spoke with felt that there was a 'visceral energy' in an AGM where a contentious vote was involved and that this had a noticeable impact on management (felt to be positive by this participant).

A perceived lack of accuracy in the proxy voting system

As already described, institutional investors were unable to confirm that their votes had been cast. This in itself creates doubts around whether the process is accurate.

"Our voting provider provided us with a spread-sheet of the way we'd voted, the way they'd registered us to vote and because of the way everything was set up we could go to our custodians via its vote agent and get the spread-sheet of how they thought we'd voted. At the end of every voting season we would reconcile the two and there'd always be differences between them....it was always troubling to find a difference between the two and then have to go through the process with our voting provider to work out why they were different." (Investment manager)

Where votes are cast for fewer than the number of votes known to be held by a 'shareholder', as entered on the register (likely to be a nominee account at a custodian bank), the votes can still be cast.

If, however there is over-voting by a shareholder (perhaps as the result of stock lending activity close to the record date), potentially, none of the votes can be cast at the meeting. Where this occurs, the registrars need to contact the vote agent to try and resolve the issue, but it is often very close to the meeting by this stage."

It is therefore highly undesirable that the number of votes cast should exceed the number of votes held. One investment adviser commented that, *"the entire voting system is predicated upon under voting"*.

Participants hinted at some of the potential systemic reasons why under voting has become endemic.

- The opacity of the omnibus system at custodian level
- The relationship between this opacity and stock lending and high frequency trading

"Actually it (stock lending) probably is no bad thing. It facilitates the market. It means that you don't have failed trades; you just have a bit more liquidity around. At the edges, though, some weird stuff happens. In effect there can be 110 per cent free float for some companies rather than 100, because there's this big passive pool that thinks they're shareholders and hold the shares forever, whereas actually those shares aren't in their hands on any given day. They're off out with somebody else. So you've got this very weird situation that in effect you've got extra shares floating around the system." (Investment manager)

Participants told us that the lack of accuracy in the proxy voting process leads to lack of confidence amongst institutional investors and an overall sense that the voting process lacks 'integrity'.

Barriers to shareholder resolutions and other shareholder activism

There are situations where investors might want to group together and jointly vote against a company on an issue or co-file a resolution on a particular issue. The opacity of the share register (exacerbated by the use of omnibus accounts) makes this more difficult.

Section 338 of the Companies Act 2006⁴⁹, provides that a company is required to give notice of a resolution once it has received requests that it do so from:

- Members representing at least 5% of the total voting rights of all the members who have a right to vote on the resolution at the annual general meeting to which the requests relate (excluding any voting rights attached to any shares in the company held as treasury shares); or
- At least 100 members who have a right to vote on the resolution at the annual general meeting to which the requests relate and hold shares in the company on which there has been paid up an average sum, per member, of at least £100.

Investors (whether institutional or individual) investing via a nominee or custodian may find it harder to identify other investors in order to collectively engage with the company. They may find it harder to collectively achieve the thresholds needed under the Companies Act to table resolutions, or require companies to give notice of resolutions. This may be exacerbated by the use of pooled or nominee accounts.

One investment manager provided us with an example of a situation where they first needed to find ninety nine other institutional shareholders and then needed to engage with other major shareholders to try and ensure that the resolution (which was approved of by the company) was passed.

When they spoke with some of the key investors which included some of Europe's biggest pension funds, none of these appeared directly on the share register. Instead these holdings were in the name of their custodian bank. Where funds were invested in omnibus accounts, the custodians were unable to provide the necessary reference codes in order to provide proof to the registrar.

Individual investor action groups also claimed that the opacity of the share register (which they perceived as caused by pooled nominee accounts at broker level) restricted the ability of individual investors to undertake collective action.

Herd behaviour in institutional proxy voting

Some participants felt that there was a degree of herd behaviour in proxy voting and that this was due to:

- Market concentration amongst proxy voting advisers

⁴⁹

http://www.legislation.gov.uk/ukpga/2006/46/pdfs/ukpga_20060046_en.pdf

- Lack of resource and lack of enthusiasm amongst some institutional investors who ‘tick the box’ with regards to stewardship.

There were suggestions from share issuers that proxy agencies had too much power. They believed this stemmed from share issuers looking at the advice given by proxy agencies and finding a strong link between this and the proxy votes cast. On the other hand, some participants defended the role of proxy advisers on the basis that all they were doing is offering research based on sound corporate governance principles.

Many companies don't like proxy advisors, because they think they are too powerful and not properly accountable to the people that use them. I just think that's sour grapes. They don't like the fact that they are not left to do what they like on governance. (Pension fund manager)

One investment manager participant candidly suggested that voting against management was regarded as, “a weapon of last resort”, to be used when engagement had failed. This participant suggested that the role of the investment manager was to support management and that voting against management ran the risk of damaging the value of the company.

According to figures supplied by Manifest, a proxy voting provider in its paper for BIS on “How companies and shareholders have responded to new requirements on the reporting and governance of directors’ remuneration”⁵⁰, average levels of dissent (either voting against or abstaining) were:

- 8.4% on remuneration reports
- 9.2% on remuneration policy

In 2014 three companies in particular attracted a significant level of dissent from shareholders. One company’s Remuneration Policy and Remuneration Report votes were only passed due to abstention votes not being counted, with 53% of shares voted to “Abstain”. Two other companies attracted large levels of “Against” votes – in the order of 30%.

According to the same report, the average ‘turnout’ (percentage of votes cast) was 71% in 2014.

One academic commentator suggested to us that there were two dimensions to proxy voting:

- Quantity of voting, which has improved over the past 10 years in the UK
- Quality of voting, which he felt was diluted by herd behaviour and default voting support for management amongst investment managers

⁵⁰ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/409714/bis-15-168-Directors-reforms-how-companies-and-shareholders-are-responding.pdf

Participants suggested that if regulation and efforts to increase voting activity simply resulted in institutional investors defaulting to the recommendations of one or two proxy voting advisers or voting with management as a matter of course then the results might be far from those intended.

Initiatives to improve proxy voting

There are a number of initiatives currently in progress to try and improve the function of proxy voting and the quality of voting. These include:

- The continuing work of the Shareholder Voter Working Group (SVWG)
- The Principles for Responsible Investing (PRI) led vote confirmation initiative
- The Red Lines initiative by the Association of Member Nominated Trustees (AMNT)

The SVWG consists of a number of industry participants, many of whom we spoke with during the process of compiling this report.

PRI are leading an initiative (involving some of the same participants and others in the chain) to explore how vote confirmation might be achieved within the existing chain structure.

“One of the key issues that some of our investors have is that they have no confirmation that their votes have been cast and counted correctly. Of course they get some kind of confirmation from the immediate next actor in the chain but not end-to-end confirmation. So we have a group of investors and other interested parties who are looking into conducting a pilot” – (PRI)

Building on PRI’s guidance for asset owners on including responsible investment in manager selection and oversight, a ‘round table’ of pension funds in consultation with fund managers has published a Guide to Responsible Investment Reporting in Public Equity⁵¹.

With regard to voting, the document calls for greater transparency from investment managers, for example:

- Clarity on any changes to proxy voting policy or processes.
- The percentage of voting decisions reviewed in house.
- Examples of how conflicts of interest are managed.
- Explanations for any deviations from proxy voting policy.

51

<http://www.uss.co.uk/UssInvestments/Responsibleinvestment/Documents/guidetoRIreportinginpublicequity.pdf>

- Outline of changes to stock lending policies.

As mentioned above, at the time of writing the AMNT was developing a common set of instructions on voting based on Environmental, Social and Governance issues that could collectively be applied by smaller institutional investors with assets in pooled funds at the level of the investment manager.

Whilst all of these initiatives were welcomed by participants, some were disheartened by the speed of progress.

“There needs to be demand for it. I don't think it has come as hard and fast as it should have done because people frankly have got so many other things to contend with nowadays, and understanding the vote, you'd be surprised. People don't even understand the basics of how their votes are going.” (Investment manager)

What more can be done to improve proxy voting?

“The mechanics of the voting system are that the custodian as an intermediary has the role to convey instructions and does so. But doesn't expend much time and effort on insuring the instructions are conveyed securely and accurately.” (Investment adviser)

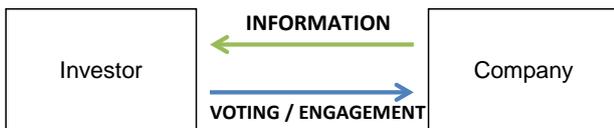
The functioning of the financial services industry is predicated upon accuracy. Regulators and participants would be most agitated if transactions and other account information were less than completely accurate (although as we have discussed, for omnibus pooled accounts there appeared to be a degree of ‘netting and balancing’ involved).

Indeed, there is one special category of voting which requires 100% participation and where the figures are fully accurate: corporate actions.

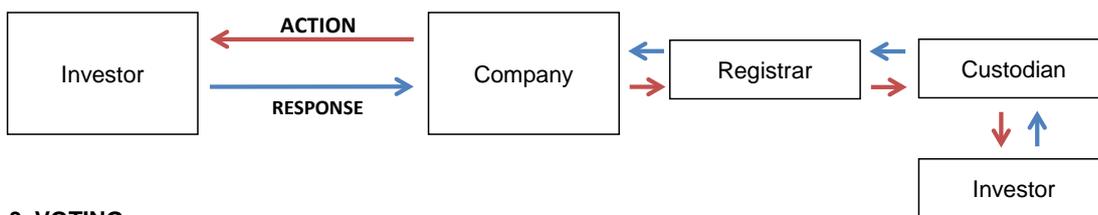
Figure 10: Corporate actions are a feedback loop; proxy voting is not

Figure 10 illustrates a simple model for voting, where information can be received by investors from companies and where votes can be sent direct from investors to companies. In the case of a corporate action, whilst the messaging is facilitated by custodians (who provide the information on who is eligible to vote on a given date) and registrars, this is more or less what happens. Proxy vote agents and proxy voting advisers are not involved in this process. Messages are sent directly from within the custodians, using the SWIFT protocol via CREST to all investors. Proxy voting involves a larger number of intermediaries in the chain, takes place over a shorter time frame and is generally treated as a lower priority activity than corporate actions.

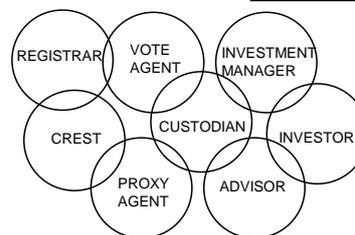
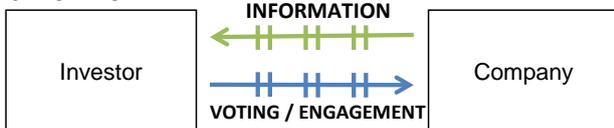
1. IDEAL MODEL



2. CORPORATE ACTION



3. VOTING



- Shorter timeframe
- Confusion of roles
- Lack of consensus
- Lower priority
- Accuracy less critical

When there is a vote on capital raising or a rights issue, this can only occur once shareholders give their approval. Custodians are responsible for corporate actions. If errors are made which involve investor losses, they can be sued.

For corporate actions there is a 'true record date' which states that if an investor holds shares on this particular date then they can participate in whatever the corporate action is. If an investor or a fund manager or a bank buys, sells or loans after that, it doesn't matter. This allows the custodian to make a clear distinction between those who are entitled to participate and those who are not and to see how many shares are owned by each entitled investor at a particular point in time.

The custodian then sends a message which provides the voting options, which might be as simple as:

- Elect.
- Do nothing.
- Sell.

The signal path for corporate actions is different from voting. Messages are sent directly from within the Custodian, using the SWIFT protocol via CREST to all investors.

“We've actually got two standards but most people will use one or the other. They're both electronic, fully STP, they're defined and kept up to date and everybody knows what the rules are. Everybody knows what they have to do to get a certain instruction in to settle. The same isn't true I guess of things like voting at the moment.” (Euroclear)

This parallel processing pathway for corporate actions illustrates that there was considerable potential to at the very least improve the accuracy of the proxy voting process.

The question of 'who pays'

Currently (2015) there are no explicit fees for proxy voting paid by investors. Custodians and asset managers tend to bundle any costs that they incur into overall contracts. Proxy voting advisers charge for advice and recommendations rather than the use of their voting platforms.

Participants argued that were a custodian, asset manager or other intermediary to explicitly charge for passing back shareholder rights to a beneficial owner, this would make the structural issues around 'ownership' explicit. Effectively the intermediary would be making a charge for something that is considered a right of ownership.

Discussions around improving the proxy voting chain inevitably turned to the question of which of the participants should pay for this.

Under the current (2015) share ownership structure, the intermediaries best placed to facilitate change were the custodians, assisted by the vote agents to which they outsourced. However, such a change would be of little tangible benefit and would create additional work for the custodians and the vote agents they use.

If instead, the question was; who would benefit from more accurate and more transparent proxy voting?

- Companies might benefit from greater transparency
- Investors would benefit from being able to show good governance (that their votes had been cast)

Another question is; who benefits from the current proxy voting system?

- Custodians benefit from a relatively cheap solution to the issue of shareholder voting which has been placed under their auspices as a result of the ownership chain
- Proxy voting agents benefit from operating messaging infrastructure which the ownership chain makes necessary

A much broader question is; who benefits from the ownership chain, of which the proxy voting chain with its attendant issues are a symptom?

- Custodians benefit from custody and other associated activities including stock lending and high frequency trading.
- Investment managers (and brokers) benefit from a default position of control over shareholder rights which are not theirs.

In summary, the proxy voting chain for institutional investors does not offer the levels of accuracy or transparency that investors expect. The infrastructure that facilitates the transmission of voting instructions is a workaround solution that is predicated on producing outcomes that are approximate and that are very difficult to verify.

Areas which might be addressed include:

- Pooling at the level of the custodian, which is considered by participants to be a key factor in creating the 'clouds of opacity' referred to by participants
- The lack of an earlier record date for voting, which encourages vote agents to pool votes before sending them to the registrar
- The degree to which it is acceptable for institutional investors to accept recommendations from proxy advisers without consideration of those recommendations or at least applying their own set of principles as a filter for those recommendations.

Conclusions

Here, the issues which affect both individual and institutional investors are summarised.

The research sought to find out:

- i. The reasons why individual investors held shares in a particular way
- ii. Whether individual investors were aware of alternative methods of holding
- iii. How investor voting procedures worked in practice
- iv. Whether investors understood the extent to which they could exercise the rights associated with their shares
- v. The fees associated with each element of the model and the investor's perception of the value added
- vi. The extent to which investors understood what they received for the fees they paid

i. The reasons why individual investors held shares in a particular way

Individual investors held shares in a range of different ways, either for historical reasons (share certificates held for a long time) or convenience and many held shares via two or more brokers or portals instead of, or in addition to, certificated holdings. When discussing certificated holdings, there was some confusion as to whether some of the paperwork they had relating to investments was actually share certificates or simply statements from their broker.

In general, individual investors tended not to factor in the degree to which they were engaged or distanced from companies when deciding which brokers or methods of holding to use. Certainly, there was no evidence that investors chose intermediation in order to distance themselves from companies. It was more the case that other factors such as transaction cost and convenience were the primary drivers of choice. The exception was amongst more engaged investors, some of whom chose to hold via personal CREST accounts.

ii. Whether individual investors were aware of alternative methods of holding

Amongst less engaged investors awareness of different holding methods and the consequences with regards to shareholder rights was low. This became particularly apparent during the equity investor follow up interviews where investors found it difficult to recall by which method (s) their shares were held and whether or not shareholder rights were available. That said, there was a considerable amount of cross-holding of shares; that is to say that many individuals held investments electronically as well as on paper and often with multiple brokers, either for reasons of security (spreading risk), or cost (finding a broker with lower transaction charges).

iii. How investor voting procedures worked in practice

In practice, the voting chain for institutional investors was felt to work poorly in that end-to-end confirmation was difficult to achieve. Indeed various pilot exercises were underway to try and achieve this at the time of writing.

Large institutional investors were able to arrange to have voting rights passed back to them via the contracts they had with their own custodian banks and investment managers.

Smaller institutional investors in pooled accounts tended not to have such contractual arrangements in place with their investment managers and instead relied on investment managers agreeing to vote proportionately on their behalf; this may have been difficult, particularly if funds were also pooled at the level of the custodian.

iv. Whether investors understood the extent to which they could exercise the rights associated with their shares

In terms of individual investors, many were unsure of whether they had access to shareholder rights or not. Some assumed they did (when from the brokers they use it is clear that they do not), and vice versa. For most individual investors, the principal of being able to vote and/or attend an AGM was more important than the practice.

There was certainly much greater appetite to participate in these activities exceptionally when there was a particular issue at stake, rather than regularly based on the annual report. In this respect individual investors are not unlike institutional investors in that there is a strong desire to distinguish between the less frequent occasions where they felt strongly (and would vote against management) and the routine. In the institutional world, this is where proxy voting advisers play an important role.

In the institutional world, voting proportionately on shares held in pooled funds appeared to remain something of a grey area. Some participants felt that the legal principles in place clearly mandated in favour of this. However, in practice the sheer volume of administration involved on the part of investment managers meant that (from what we were told anecdotally) some discouraged smaller pension funds from exercising these rights. Moves towards collective voting schemes, such as the AMNT's Red Lines initiative were felt to offer the most immediate opportunity of improving the degree to which smaller funds might have access to 'voice'.

v. The fees associated with each element of the model and the investor's perception of the value added

Fee structures in the institutional investment chain were not clear cut. There was bundling and opacity in relation to (for example) investment management. Some fee structures such as performance fees charged by investment managers to a pension fund were impenetrably complex.

All of the relationships between beneficial investors (pension funds), investment consultants, investment managers and custodians were determined by negotiated contracts which were frequently determined based on the value of assets invested.

Some funds openly questioned the extent to which custody fees, which were mandatory within the current structures and charged on a percentage basis, were justified. It was felt that custody did not add value. The costs of custody and administration involved in nominee accounts were often passed on by brokers to customers in the form of an annual charge or monthly account management charge based on a percentage of the value of the portfolio. There was a wide range of fees for execution only servicing with some of the larger portals making no charge and some of the stockbrokers charging a fixed percentage charge (up to 0.02% of total value), but often capped at a particular figure (e.g. £100 maximum charge). Individual investors tended to be more focussed on transaction charges (often stated in cash terms rather than a percentage) and accepted custody and administration charges as a 'relationship cost'.

Each broker operated a subtly different business model and this was reflected in their fee structures. Pooled nominee accounts were reckoned by brokers to be easier and cheaper to administrate than designated accounts, although there was little evidence that designated accounts (more often offered by stockbrokers servicing higher net worth clients) were charged at a higher rate. In general, brokers either moved towards streamlining their offer to focus on one method of holding, or were else moving in that direction. This means that only a minority offered either designated account or CREST accounts as options.

Brokers talked to us about added value with regards to the benefits for individual investors in consolidating their shareholdings with a particular broker for convenience. For example, they could receive a consolidated tax voucher for all dividends and (for those brokers providing access to shareholder rights) they could conduct all voting and/or request all documents via one online portal. However, clients generally did not consolidate their shareholdings either with one broker or even via one method of holding; many continued to hold shares in certificated form. The more active used different brokers either based on transaction fees or product availability. Therefore in practice little value was added (or felt) by individual investors (other than those receiving and paying for advisory or discretionary servicing).

vi. The extent to which investors understood what they received for the fees they paid

In relation to institutional investors, this related to the transparency of the chain. The institutional investment chain had evolved over time, but was, for the most part not questioned by many of the institutional investors to whom we spoke. Irrespective of any concerns about transparency, they accepted that there were fees for advice, fees for management, fees for custody and fees for other services supplied to them. Some older more experienced participants who had worked across different links in the chain had a better understanding of what each of these services involved, and some questioned the added value in some services, particularly custody.

In the individual investor follow up interviews we found that most tended to have low awareness of any fees paid to brokers and what these fees were for. There was much greater awareness around transaction fees, and lower fees tended to attract more active shareholders to brokers and platforms. In general, the higher administration and custody charges (in the few cases where this was explicit in the broker's terms of business) tended to be paid by higher net worth investors using stockbrokers. For these customers, the

costs of administration and custody were small relative to the overall costs of brokerage and the sums invested, and therefore accepted as a small additional cost involved in their stockbroker relationship.

Other parallels between the individual and institutional voting chains

Whilst individuals and institutions were very different in terms of scale, there were parallels between how the chains function and the effects on participants:

- In both investor communities, there were relatively large numbers of investors, who had low interest in exercising shareholder rights;
- In both communities there were smaller numbers of highly engaged investors who felt very strongly about shareholder rights and their ability to exercise them;
- Institutional investors and some individual investors were subject to pooling of their assets with other investors and had very little control over how this was done;
- Individual and institutional investors had to expend effort in order to obtain access to and exercise shareholder rights;
- In both communities there were those who felt that they were excluded from accessing and exercising shareholder rights;
- In both communities, there were brokers (or investment managers) who perceived that the roles of asset management and stewardship were intertwined; and
- In both communities, investors had become systemically distanced from the companies they invested in over time.

A key difference is that institutional investors were encouraged to exercise their shareholder rights where possible under the Stewardship Code⁵² which follows a 'comply or explain' regime. However many smaller beneficial investors were not proactive about gaining access to these rights, and similarly their investment managers exercised these rights on their behalf and were not proactive in passing them back.

Brokers asserted that nominee accounts were investor-centric in that individual investors:

- Had a convenient central point of access for all their individual equity investments;
- Received one consolidated tax voucher; and
- Received dividends paid to one central location.

⁵²

<https://www.frc.org.uk/getattachment/e2db042e-120b-4e4e-bdc7-d540923533a6/UK-Stewardship-Code-September-2012.aspx>

However, what we have seen is that individual investors tended to use a variety of different holding methods and brokers:

- Nominee accounts were only convenient for those shareholdings held by a particular broker; we encountered few individual investors amongst those we spoke to in the follow up interviews who held all their individual share investments with one broker.
- Currently (2015), the only solution for those wishing to consolidate their holdings is to transfer their paper shares to a particular broker and use this broker for all of their holdings.

This widespread usage of nominee accounts conflates brokerage (buying and selling) with 'holding'. At the time of writing, there was no fully dematerialised option that did not tie a customer to a particular broker and that did not incur administration fees related to custody (in nominee accounts).

Where a discretionary relationship is in place, there is a solid argument for a broker to hold shares on behalf of a customer. The case is less clear where such a relationship does not exist.

At the time of writing, where an independent financial adviser (IFA) advised and facilitated the purchase of collective investments, there was no chain of ownership between the individual investor and the supplier of the financial product (whether equity based, debt based or some form of structured product⁵³). There was no need for any third party to hold the rights to this product on behalf of the customer. The customer received information direct from the supplier and can sell directly via the supplier. The broker model for individual shares was something of an anomaly in this respect.

Both individual and institutional investors invest in shares via structures that distance them from their investments. The current ownership chains are neither truly certificated nor truly dematerialised. These structures operate as though paper processing and safe storage is still required. One participant suggested that a large technology company could be tasked with devising an elegant, low cost, secure alternative solution.

Final Thoughts

Both the Kay Review and the Law Commission have questioned whether the level of intermediation involved in investing in shares in the UK is appropriate. Amongst the participants we interviewed, opinions were mixed:

- Some of the larger pension funds and participants who had experienced roles in different areas of the investment chain suggested that there was excessive intermediation, in particular in the area of custody

⁵³

An investment vehicle where the return is linked to the performance of an underlying index

- The academics we interviewed shared the view of the larger pension funds and felt that structural change was necessary.
- Other intermediaries directly involved in the chain found it somewhat difficult to envisage anything other than the existing structures with which they interact on a daily basis.
- Stockbrokers and investment managers found the existing chains convenient and stable; both in the sense of financial security, but also in the sense that their business models (and revenue flows) were reliable and predictable.

At the time of writing, there were a number of initiatives (such as the Red Lines voting approach and the work of the Shareholder Voting Working Group) that were attempting to make improvements to shareholder voting within the existing structures.

Appendix I: Methodology in Detail

Individual investor survey

Via Populus, we ran a series of questions on a consumer omnibus, conducted via telephone over the final weekend of January 2015.

The Populus telephone omnibus has run for nearly 10 years and is established as a high quality methodology

Sample & Methodology The original sample consisted of a 1,000 nationally representative telephone sample of GB adults over the age of 18

50% of the sample were contacted via landline and 50% via mobile to ensure that the correct proportion of mobile only households was achieved. Quotas were set on age, gender and region and the data weighted to the known GB profile of age, gender, region, social grade, taken a foreign holiday in the last 3 years, tenure, number of cars in the household, working status, and mobile only household. This was to try and ensure as far as possible that the sample is representative of the population as a whole.

Purpose and Objective

The objective of the survey was to provide a universal view on UK share ownership, providing volumetric data on:

- How many people own shares of different types
- Frequency of trading / when last traded shares and channel for trading
- Awareness / usage of voting rights
- Attitudes towards voting rights
- The extent to which people know they are in nominee accounts
- The level of awareness of loss of rights
- The degree to which shareholders are concerned about loss of rights

A copy of the omnibus questionnaire is be provided on page 152

Individual Investor sub-survey of engaged shareholders

By arrangement with two shareholder associations we arranged for their membership to respond to the omnibus questionnaire.

We were careful in our representation of the data not to mix these findings with the findings from the omnibus. We knew that these people were more likely to be engaged on

the issues of shareholder rights and that they were at risk of being heavily 'primed' by articles and campaigns on the subject of shareholder rights on the websites of their associations. 331 ShareSoc members and 69 UKSA members responded.

Purpose and Objective

To better understand the views of a much more highly engaged audience where we would expect to hear stronger views expressed.

Individual investor qualitative survey

This consisted of a more detailed qualitative survey amongst shareholders, adopting a stratified sampling approach to ensure that it included all of the key audiences by behaviour and attitude.

Twenty minute semi-structured telephone interviews were undertaken by BDRC Executives and qualitative interviewers from Perspective Research Services (a sister company).

The numbers of interviews conducted are supplied in brackets. BDRC adopted a pragmatic approach to sampling: about a third (32) of the respondents were sourced via their responses to the omnibus.

- CREST personal customers (of whom there are only about 20,000 nationally) were sourced via the engaged investor surveys.
- The remainder were sourced via national networks of recruiters

The benefit of adopting this approach was that we were able to source respondents with specific shareholding characteristics in a short timeframe. There was some risk of skewing the sample in favour of more knowledgeable respondents. The one segment where we experienced this to some degree was the paper shareholder segment, where we might have expected to speak with some less sophisticated audiences with a small number of share certificates and no other individual shareholdings.

Respondents were selected from:

- Those who responded to the omnibus and agreed to be re-contacted
- Those who responded from shareholder action groups:
- NB: We were careful only to use this sample for audiences where we would expect higher engagement in any event, such as CREST personal account holders
- Free found shareholders supplied by a national network of recruiters
- Shareholders recruited from sample of higher net worth consumers (in order to find advisory and discretionary customers)

In essence the audience for the sample was recruited on a pragmatic basis, in the hope and expectation that we would encounter a range of views within each sub-group. In the absence of any justifiable or credible hypotheses with regard to what a representative sample of each sub-group *might* look like (in terms of demographics, attitudes, shareholdings etc.), this was the only practicable course of action.

1. Those holding shares on paper only (with no broker relationship in place) (20)

1. Those holding shares electronically via an execution only service

- **Where voting rights are not available (15)**
- **Where voting and other rights are available (15)**

2. Those holding shares electronically via a broker – i.e. where there is a degree of servicing involved (advisory)

- **Where voting rights are not available (15)**
- **Where voting and other rights are made available (15)**

3. Those with a discretionary relationship with their broker – i.e. the broker decides what to buy, sell and hold (10)

4. Those holding shares electronically directly via a CREST sponsored account (10)

For efficiency, and also to provide comparative data, the omnibus questions were used (at least partially) as a screening document in order to identify the different audiences listed above.⁵⁴

Findings were analysed by sub-group in order to look for consensus as well as range of behaviours and opinions. The aim was to produce two levels of analysis:

- An overview of the participants within each segment; and
- A 'pen portrait' of the segment.

⁵⁴ On reflection and after discussion with BIS it was decided not to include the views of expats and foreign individual investors in the survey, on the basis that these would be difficult to reach, may not be representative and may have quite different and disparate views

Purpose and Objective

The survey covered the following topics derived directly from the ITT:

- Degree of engagement with companies where shares are held (on paper and/or via a broker);
- Perception of fees paid and what these are for – e.g. transactional vs advisory or discretionary;
- Perception of any additional fees for use of nominee accounts / CREST;
- Views on the relevance and importance of shareholder voting;
- How shares are selected and whether engagement with the company is significant;
- For those who do it: what exercising their shareholder rights adds to their experience and perceived value as shareholders;
- Degree to which they feel their broker encourages shareholder engagement; and
- Perceptions of how easy it is to switch brokers. What would that entail for them?

The individual investor survey (qualitative) is in Appendix II of this document

Investor case studies

At the end of the survey we asked a re-contact question. We then selected **eight individuals** from across the various sample groups to take part in a longer conversation (45 – 60 minutes), either over the phone or (where possible) face-to-face.

These interviews were conducted by the executive team working on the project.

Selection was made on the basis of:

- Variety – different types of investor (to represent the audiences across the spectrum as per our sample frame; and
- To illustrate viewpoints that seen as broadly representative within the overall sample based on analysis from survey findings

Purpose and Objective

This provided depth of insight as well as breadth of coverage from the individual investor audiences and was able to 'bring them to life' as individual shareholders.

Interviews with brokers

We conducted a series of eight face-to-face depth interviews and 18 shorter telephone interviews with brokers who offer services to individual clients, including stockbrokers, banks and other organisations.

These interviews were conducted by members of the executive team.

We wanted to explore and understand the views of:

- **Brokers who offer voting rights;**
- **Brokers who don't offer voting rights;**
- **Brokers who offer to sponsor clients via CREST;**
- **Brokers who offer discretionary and advisory services (mainly to high net worth clients); and**
- **Brokers who offer execution only services to a wider range of clients, including those who are frequent traders.**

Purpose and Objective

We wanted to understand:

- Their business and their clients;
- How value is added – from their perspective;
 - How they manage shareholdings for clients;
 - What, if any shareholder rights are offered, on what basis and to what extent these are taken up - Their own detailed opinions on the subject;
 - Challenges in offering shareholder rights; and
 - Costs / perceived costs and complexities involved in offering shareholder rights.
- Views on offering access to CREST via sponsored membership;
- General perceptions of the shareholder model for individual investors / whether the current system is fit for purpose;
- For discretionary brokers – how they vote the shares they hold for clients? What, if any other intermediaries are used;
- The role of pooled omnibus accounts; and

- Their relationships with custodians and or sub-custodians. Whether any stock lending takes place on behalf of individual investors and how any revenue is accounted for

The broker topic guide is in the appendix on page 160 of this document

Broker volumetric data

We conducted desk research, looking at all the stockbroker and portal websites, and supplementing this information with brief telephone calls where required.

Purpose and Objective

To measure the broker industry offering share dealing services to clients

How many offer:

- CREST personal accounts
- Individual nominee accounts
- Pooled nominee accounts

How many offer:

- Information rights, on what basis – what if any fees are incurred
- Voting rights
 - On request
 - On their platform/ online

It would be very difficult to make any assertions around **numbers** of clients using a particular method (or volumes) from talking with brokers. Part of the issue is that the largest share-trading 'platforms' (serve disproportionately high numbers of clients, many of whom are frequent traders (as we describe in our market overview below).

Institutional Investor Research

The most complex area of the research was to explore as far as possible (within relatively few interactions) the institutional investor chain between share issuers and investors.

The diversity in the chain is wide and includes:

- Company secretaries – the ‘end customer’ - both at an association level and individual company level
- The registrars
- CREST
- Proxy companies:
 - Proxy voting agents
 - Proxy voting advisers
- Custodians and sub-custodians
- Investment managers
- Beneficial owners:
 - Pension fund managers
 - Investment fund managers
 - Non-regulated fund managers
 - Charities / sovereign wealth funds

Reaching decision makers in these organisations was challenging and could not be reasonably achieved via traditional market research recruitment processes.

We relied upon:

- BIS contacts and stakeholders
- Referrals from these contacts (and their contacts etc.)
- Contacts made directly by the project directors via email and telephone – sourced from:
 - Events information – speakers on governance issues etc.

- Written papers, where contacts were included

A caveat is that this was a relatively small sample of participants in the chain and we tended to speak with those who are highly engaged with regards to voting and governance. For example, within investment management companies we spoke with those responsible for governance, rather than the fund managers. Additionally, whilst larger pension funds were keen to speak with us and describe how they achieve good governance, we experienced difficulty in speaking with smaller pension funds directly. Those smaller pension funds we did contact did not appear confident with the subject matter, although this may be due to lack of seniority of those we spoke with.

In total, we spoke with 36 individuals involved in the chain in a series of 13 meetings and 18 telephone conversations. Whilst this element of the research serves well in our view to illustrate the views held by senior intermediaries and other participants, it is qualitative research and does not claim to measure the strength of these views held generally within the sector.

All interviews were conducted by members of the executive team and varied in duration from 45 minutes up to 2 hours.

Purpose and Objective

In order to meet the objectives of the research we needed to cover the following topics with investors, intermediaries and share issuers.

Investors

- Their own understanding of the chain and how it works
 - How they describe each link
 - What cost does each link add
 - What value each link adds
- How well they feel their voting intentions are expressed
 - When and where it works well
 - Where it doesn't work well
- The relationships with investment managers / custodians, CREST and company registrars
- How they have adapted the ways in which they exercise their shareholder rights
- Any future plans for change

Intermediaries

- Their own understanding of the chain and how it works
 - How they describe each link. What cost / value each link adds
- What is their role in the process?
 - What fees do they charge? Who do they charge? What value is added?
- How do they ensure that they transmit the voting intentions of the beneficial shareholder
- How do they ensure that voting intentions reach the registrar /the company
- What, if any, are the loose links in the chain?
- Relationships with investment managers / custodians, CREST and company registrars
- How, if at all, they have changed the ways in which they take part in the voting process
- Any future plans for change

Appendix II: Survey documents

Individual investor omnibus

Intro: I'd like to ask you some questions about holding shares in companies

- Q1 ASK ALL. READ OUT
Do you currently own shares in any UK based companies?
- Yes – shares in a publicly traded company _____1
Yes – shares in a private company that are not publically traded _____2
No shares held _____3
Don't know _____4

- Q1a ASK ALL. READ OUT
And can I just check, do you hold any **individual** company shares in...
1. A self-invested pension plan, also known as a SIPP
 2. A Stocks and Shares ISA
 3. Neither of these

RESPONDENT MUST CODE 1 AT Q1, OR 1 OR 2 AT Q1A TO CONTINUE, REST CLOSE

- Q2 READ OUT.
How did you get the shares you currently hold? Code all that apply
1. I bought them on the advice of a professional, such as a broker
 2. I decided that I wanted to buy shares in a specific company
 3. I was a customer of an organisation that floated/demutualised and was given/offered the shares (e.g. Halifax)
 4. I bought shares when a formerly public owned company floated (like British Gas or BT)
 5. I inherited or was given the shares by someone
 6. I bought or was given shares in the company I work for, sometimes called a Sharesave scheme
 7. Other

- Q3 READ OUT
How do you hold your shares? Code all that apply
1. You have paper share certificates
 2. Your shares are held for you by a Broker
 3. You have a Personal CREST account
 4. Your shares are held for you by the company that issued them, this is sometimes known as a corporate nominee account

Q4 READ OUT

In the last year how often have you

- a) Bought any shares
- b) Sold any shares
- c) Checked the share price of the shares you hold
- d) Investigated how any of the companies you hold shares in were doing – their future plans and strategy etc.

Collect timeframe for each item

a) b) c) d)

Have not done this	1
Have done this once or twice	2
3-6 times (up to once every other month)	3
7-12 times (up to once a month)	4
13-24 times (up to twice a month)	5
25-52 times (up to once a week)	6
More often than once a week	7

Q5 IF Q4=2-7 FOR SHARE SALES, READ OUT

Thinking about the last time that you sold any of these shares, how did you do that?

Your broker/adviser recommended the sale and then organised it for you	1
You decided what you wanted to sell and asked a broker / financial adviser to make the sale for you _____	2
You did the trade yourself online _____	3
You used a bank service – in branch _____	4
Other _____	5

Q5a IF Q4=2-7 FOR SHARE PURCHASE, READ OUT

Thinking about the last time that you bought any of these shares, how did you do that?

Your broker/adviser recommended the purchase and then organised it for you	1
You decided what you wanted to buy and asked a broker / financial adviser to make the purchase for you _____	2
You did the trade yourself online _____	3
You used a bank service – in branch _____	4
Other _____	5

Q5b ASK ALL READ OUT

How would you rate your knowledge of buying and selling shares? Would you say ...

- You are happy buying and selling shares without any advice from a broker
- You do buy and sell without advice from a broker but also value their advice at times
- You tend to buy and sell on advice from a broker but do sometimes make your own decisions
- You rely entirely on a broker or other adviser to tell you when to buy and sell

Q6 ASK ALL
Apart from receiving a dividend, as far as you are aware, do your shares give you personally any shareholder rights such as being able to vote at company AGMs? These could be rights that your broker has passed back to you, or that you hold directly

Yes, for all the shares you hold _____ 1
Yes, for some of the shares you hold _____ 2
No, not for any shares you hold _____ 3
Don't know / not sure _____ 4

Q7 ASK ALL WHO HAVE RIGHTS (CODES 1-2 AT Q6)
In the last three years have you exercised any of the following rights as a shareholder? Have you...

Voted by post/online _____ 1
Attended an AGM _____ 2
Sought information from the company that issued the shares
(whether via a broker or directly) _____ 3
Something else _____ 4
Have not exercised any rights _____ 5

Q7a ASK ALL WHO HAVE RIGHTS (CODES 1-2 AT Q6):
How do you feel about exercising your rights as a shareholder, for example to vote at an AGM?
Which of the following, if any, apply to you?

I think it's important to vote and I do so whenever possible
I vote on things that seem important, but otherwise don't bother
I don't / rarely vote because I don't think my vote makes any difference
I don't / rarely vote because it's a lot of hassle to do so
If I could vote online just by clicking a button I would vote more often

Q8 ASK ALL
When company shares are held on your behalf by a Broker, they are held in what is called a nominee account. This also includes any individual shares that are part of a SIPP or a Stocks and Shares Isa.
Because the shares are not technically held in your own name, this means that you do not automatically have any shareholder rights such as being able to vote at the Annual general meeting. Some stockbrokers pass these rights back to the individual shareholders but many do not.

Were you aware of this?

Yes

No

THOSE WHO HAVE SHARES WITH BROKERS (CODE 2 AT Q3 OR CODES 1-2 AT Q1A) ARE ELIGIBLE FOR Q8A-C, REST TO Q9

Q8A IF Q8 = YES: Which of these best describes how you feel about this?

I asked my broker to pass these rights back to me and they did
I asked my broker to pass these rights back to me but they have not done so
If there was an important vote coming up I might ask my broker to pass the rights back to me
I have no plans to ask my broker to pass these rights back to me
It does not concern me as I would never want to vote

Q8b IF Q8=NO: Now you know, which of these best describes how you feel about this?

Now I know, I plan to ask my broker to pass these rights back to me
If there was an important vote coming up I might ask my broker to pass the rights back to me
I do not plan to ask my broker to pass these rights back to me
It does not concern me as I would never want to vote

Q8c ASK ALL WHO ASKED FOR RIGHTS BACK AT Q8A BUT WERE NOT GIVEN THEM:

And what reason did the broker give for not passing these rights back to you?

TYPE IN

Q9 ASK ALL COMPLETING THIS SECTION. **OMNIBUS PROVIDER TO SIGN OFF TEXT**

Thank you for your time today. As a follow up to this study we may want to speak to you again in the near future. May I ask if you would be willing to take part in some further research on this topic?

IF YES COLLECT:

Name.....

Telephone number.....

Email address.....

END

Individual investor survey

BACKGROUND

I'd like to understand more about how you came to hold, buy and sell shares in the way that you do now.

Elicit the 'story'

- When did you first acquire shares?
- When, if at all, did you start to buy, sell or trade shares? How? Why?
- What were your main motivations then? How, if at all, have they changed since then?
- What does holding or trading shares mean to you?
 - o *E.g. is it a hobby / a chore?*

I'd like to understand more about the shares you hold, where you hold them and why, but be assured that I'm not going to ask you anything about the number or value of these shares.

Briefly, can you tell me (approximately) how many different companies you hold shares with:

- on paper, where you hold the certificate
- electronically, where you do not hold the physical certificates

*Just to clarify when we talk about paper shares, we only mean those issued directly by the company invested in, **where you hold the actual certificate** with your name, the number of shares, the class of shares, and the nominal value of each share.*

Are all your shareholdings similar in terms of how long you might hold them for and **how interested you are in the end companies?** What, if any, are the differences? Why?

- e.g. do they hold some for the long term – but do some day trading as well?

BROKER CHOICE

Which, if any, stockbrokers or portals (or banks) do you use to buy and sell shares?

How did you come to use these particular stockbrokers or portals?

Why do you use this/these particular stockbroker / platform (s) rather than any of the other options available?

When you buy shares through these organisations, do you receive a paper share certificate or are the shares held electronically via the broker?

PROBE ON: Recommendation (from who?) / Personal relationship (i.e. with a stockbroker) Price (transaction cost / cost of relationship) / Convenience / Quality of advice/ Quality of service / any mention of shareholder rights and/or CREST accounts / named nominee accounts

To the best of your knowledge, where and how are your electronic shares actually held? **PROMPT IF NECESSARY:**

- By your stockbroker
- In a nominee account with your name on
- In a pooled nominee account – (or in an ISA or SIPP)
- In a **CREST** sponsored account
- In a custodian bank

- Other
- Don't know / not sure

When you set up your account with this stockbroker / portal, was this something which you considered important, or which influenced your decision in any way? How?

At the time, were you aware that how and where your shares were held had any impact on your rights as a shareholder? **PROBE**

ALL THOSE WITH SHARES IN POOLED NOMINEE ACCOUNTS: The fact that your shares are held within a pooled nominee account. What do you think this might mean in practice in terms of:

- Who actually owns the shares?
- Who has beneficial rights over the shares?
- Security?

Other than transaction fees, do you pay any other set fees per month or year?

What is your understanding that these fees are for?

PROBE ON: Advice? Administration / Holding shares on your behalf (nominee accounts) / other

SHAREHOLDER ENGAGEMENT / SHAREHOLDER RIGHTS

IF PAPER SHARES HELD: Thinking just about the companies for which you hold **paper shares**. Why did you choose to invest in these particular companies?

PROBE ON ANY SPECIFIC REASONS FOR HOLDING THESE SHARE

- – i.e. **personal connection / previous employer / specific interest etc.**
- **OR is it purely based on price / potential gain / broker advice / etc.?**

How much would you say you **know** about or are **engaged with** these companies?

For example: Other than their share price, to what extent do you follow what's happening in these companies, either in the financial press or online?

To what extent do you read annual reports? How useful is this information to you? Why?

- *i.e. does the information help them to take decisions around voting or whether they should buy more, or sell shares?*

To what extent do you use your rights as a shareholder to vote and/or receive other benefits? Why? Why not?

IF HAVE NOT VOTED / DO NOT VOTE: Under what circumstances, if any, would you want to vote? Why?

IF HAVE VOTED: What does it mean to you when you're able to vote? I'd like to get a sense of what your motivations are when you do vote; what thoughts or ideas you have in your mind that lead you to vote? **PROBE** in order to explore motivations:

- *e.g. do they vote because they think it is the 'right' thing to do? Does it give them a greater sense of 'ownership'? etc.*

What would it mean to you if

- You did not receive information / annual reports on the companies you have paper shares with?
- You were no longer able to vote or receive any other shareholder benefits?

IF SHARES HELD ELECTRONICALLY

Now, thinking just about the companies for which you hold **electronically**. Why did you choose to invest in these particular companies?

PROBE ON ANY SPECIFIC REASONS FOR HOLDING THESE SHARE

- – i.e. **personal connection / previous employer / specific interest etc.**
- **OR is it purely based on price / potential gain / broker advice / etc.?**

How much would you say you **know** about or are **engaged with** these companies?

Other than their share price, to what extent do you follow what's happening in these companies, either in the financial press or online?

SHAREHOLDER RIGHTS

Just to clarify, do you receive information, such as annual reports, about the companies that you hold shares in electronically via your broker / platform? Does this information come directly from the companies themselves or via your stockbroker / platform?

How did you get access to these reports and other information? Did you have to ask for them or are they routinely supplied via your broker?

In what form does this information come (i.e. paper through the post / download pdf online)

To what extent do you read annual reports? How useful is this information to you? Why?

- *i.e. does the information help them to take decisions around voting or whether they should buy more, or sell shares?*

THOSE WHO DO NOT RECEIVE INFORMATION ON THE BUSINESSES THEY INVEST WITH

- To what extent would it be useful for you to know more about the businesses you invest in?
- What, if anything, do you feel you miss out on by not receiving this information?

For your shares held electronically, *are you able to* receive shareholder rights to vote on AGMs and on other decisions?

IF YES: To what extent do you use these shareholder rights? Why? Why not?

How **do** you vote? **PROBE:** i.e. directly via post, online via the broker (voting buttons).

IF HAVE NOT VOTED (BUT COULD): Under what circumstances, if any, would you want to be able to vote? Why?

IF HAVE VOTED: What does it mean to you when you're able to vote? I'd like to get a sense of what your motivations are when you do vote; what thoughts or ideas you have in your mind that lead you to vote? **PROBE** in order to explore motivations:

- *e.g. do they vote because they think it is the 'right' thing to do? Does it give them a greater sense of 'ownership'? etc.*

What would it mean to you if:

- You were not able to receive information / annual reports on the companies you have electronic shares with?
- You were not able to vote or receive any other shareholder benefits?

IF NOT ABLE TO VOTE

When you started using this broker / portal, to what extent did you consider that you would not have voting rights and other shareholder rights? Did you even know about this? / How concerned were you about this?

Have you enquired about having voting rights over your shares? What were you told?

What, if anything, do you think that not having these rights means to you as a shareholder:

- In terms of loss of rights?
- In terms of how shares are held / who 'owns' them?

As far as you are aware, who, if anyone **does** vote on your shares?

THOSE WHO HAVE CREST ACCOUNTS

You've said that you have a CREST account in your name via your broker. Please can you tell me the reasons why you decided to open a CREST account and what, if any, additional value you feel you get from this? **PROBE IN DETAIL**

Can you tell me how much you currently pay in order to have a **CREST** account in your name? To what extent do you feel that this is value for money? **PROBE IN DETAIL** Why?

Thank you for your time today. As a follow up to this study we would like to speak to a few people in a bit more depth, perhaps arranging a meeting with you. Is this something that you would be willing to consider?

IF YES, CAPTURE DETAILS

Broker topic guide

INTRODUCTION

Moderator to explain purpose of research: we are interested in understanding the role of brokers with regards to shareholder rights.

We are also interested in exploring the chain between the beneficial investor and the share issuing company.

Overview of respondent role within the broker.

Overview of the broker by type of customer (typical customer typologies), how they service customers / what options they provide in servicing.

If there are different servicing options available, which types of clients choose which options? Why?

THE BROKER OFFER

Why do customers use your company as opposed to any of the other brokers or portals out there? What are your key selling points?

- i.e. relationship based / price / servicing /convenience?

When a client holds shares with you, how are these held?

- CREST personal accounts
- Individual nominee accounts
- Pooled nominee accounts

Why do you hold client shares in this way?

What, if any, are the issues you might have in using the other options? **PROBE IN DETAIL, PARTICULARLY AROUND CREST ACCOUNTS**

IF DIFFERENT OPTIONS OFFERED: What proportion of clients use these different options? (Ideally, ask if they know by value.)

POOLED NOMINEE ACCOUNTS

IF USED To what extent do clients ask you about the use of pooled nominee accounts? What do they ask?

Are clients aware that funds are held in this way? Do they read the 'ts' and 'cs'?

What, if any, issues do you face as and when clients realise their funds are held in pooled nominee accounts?

What are the benefits for you as a broker in holding client shares in pooled nominee accounts?

PROBE WITH REGARD TO:

- Convenience / ease / low cost
- Income from clients

- Income derived from the account – i.e. dividend interest / any income (or fee offset) from their bank or sub-custodian with regards to stock lending or other activities

From the client perspective, are there any security issues with regard to where their shares are held?

PROBE WITH REGARD TO

- The limits of liability of the broker / the custodian or sub-custodian (where relevant)

SHAREHOLDER RIGHTS

To what extent do you offer **information rights** to clients? How do you offer these rights?

- i.e. do they pass client details back? Do they hold pdfs of annual reports on their site?

What do you offer if a client asks for information rights with regards to some of their shares? How, if at all, is this charged to the client?

How 'visible' is this offer on your website, terms and conditions or other materials? Why?

How do you view shareholder requests for information rights?

- i.e. a nuisance, something they encourage, other?

To what extent do clients know they have a right to ask for information rights? Is this something they ask about when they start to deal with you?

IF APPLICABLE If you were to make it more widely available and/or known, do you think more clients would ask for information? Why? Why not?

To what extent do you offer to / pass back **voting rights** to clients in nominee accounts? How do you offer these rights?

To what extent do you facilitate voting rights for shareholders? How do you offer these rights?

- i.e. via buttons on the site / links to other parts of the site?

To what extent do clients vote using these methods?

What do you offer if a client asks for voting rights with regards to some of their shares? How, if at all, is this charged to the client?

How frequently are you asked to pass on information rights? How many clients decide to go ahead (and pay – if charged)?

Are there particular situations when a client might suddenly want voting rights? Under what circumstances?

IF DO NOT OFFER VOTING RIGHTS

Why don't you provide voting rights? Would you like to be able to offer voting rights to clients?

What, if anything, would make it easier for you to provide voting rights?

Do clients ask about voting rights? What do you tell them?

Do clients ever ask to attend AGMs? In what circumstances? How, if at all, are you able to help with this?

SIPPS AND ISAs

Do you offer to manage SIPPS and ISAs containing individual shares?

Do clients ever ask for information rights on shares held within these? What would be your position if they did ask? Why?

Do clients ever ask about voting rights?

THE SHAREHOLDER CHAIN

We'd like to understand more about the chain of ownership and/or voting for individual investors.

If we start from the individual investor on one side and the share issuer on the other, which organisations play a role in the chain for your clients?

- Brokers
- Nominee account (pooled / individual / CREST) / custodian bank
- CREST
- Registrar
- Company

- Other (proxy voting services company?)
- Any other

How (if known) has this chain changed in recent changed?

Why has it changed / what has driven the change?

Has this change been for the better/worse? Why? How?

Are all of these links in the chain really necessary? Why? How might this chain be simplified?

Of the charges you make to clients, how would you allocate these costs to the different constituents in the chain (on a percentage basis)?

Do you as a broker vote on behalf of your clients (discretionary clients)? How do you do this? Who advises you? Do they vote, or are there others in this chain? (i.e. asset managers / proxy voting companies etc.)

Where appropriate ask for leads in any intermediary companies used

THE FUTURE

What, if any, changes do you anticipate in terms of your offering to individual shareholders and traders in the future? Why?

THANK AND CLOSE

Institutional investor topic guide

Outline Topic Guide for institutional investors

INTRODUCTION

Moderator to explain purpose of research: we are interested in understanding how the chains between beneficial investors and UK companies issuing shares function:

- Who are the participants?
- What value is added by each link?
- How are voting rights affected?

Overview of respondent role and their company's remit

To what extent are you aware of some or all of intermediaries which sit between you and the end company? For example, custodians, sub-custodians, proxy advisers, proxy voting agencies). **NB: MAY NEED TO PROBE TO UNDERSTAND WHERE RESPONDENTS HAVE FULL VISIBILITY AND WHERE THEY ARE 'GUESSING' / HYPOTHESISING**

- If possible, ask the respondent to talk through / illustrate / draw (during the interview):
 - o A chain of ownership, showing where the shares are actually held
 - o A chain for voting rights showing what happens to their votes (whether used or delegated)
- How (if known) have these chains changed in recent changed?
 - o Why have they changed / what has driven the changes?
 - o Have these changes been for the better/worse? Why? How?
- **AT END OF INTERVIEW:** Are all of these links in the chain really necessary? Why?

Ideally, we'd like your assistance in being able to follow one or more of these chains (in particular the voting chain) through to the registrar. At the end of the interview I may ask you to put us in touch with your contact in one of the intermediaries you've mentioned.

INSTITUTIONAL BENEFICIAL OWNERS

- Trust based pension schemes
- Insurers and providers of contract based pension schemes
- Open and closed-ended funds offered to retail investors (i.e. UCITs / Investment Trusts / AIFs)
- Sovereign Wealth Funds / Charities / Others who are investing with fewer regulatory restrictions – Norgesbank, Wellcome Trust, CofE Investment Fund etc.

HOW UK EQUITIES ARE HELD

How do you hold UK equity assets – i.e. whose name is on the register?

Do you use a custodian or nominee service? If so, who is this operated by?
(The asset manager, the broker, or a bank, or someone else?)

Are your equity holdings pooled into single accounts with other investor clients? At what level(s) are your assets pooled? (NB: trust based occupational pension schemes must hold their assets with a custodian.)

Why do you hold assets in this way?

- Probe on impact of regulation / convenience / oversight etc.

What is the cost of these services? On what basis are they charged? How transparent are the charges? Are they bundled together with any other charges?

I'd like to understand how transparent these holding services are?

- How frequently are you able to obtain a statement of your holdings in pooled accounts?
- Can your shares held in these pooled accounts be lent out? **IF YES** By whom, and on what basis?

How often do you review the mechanics of this?

ASSET MANAGEMENT AND ADVICE

Roughly what proportion of the assets you hold does this account for? (UK equities)

What proportion of these UK equities do you...

- Manage in house or via an associated firm (such as an investment management subsidiary of an insurance firm)?
- Give to an external asset manager to manage?

I realise that commercial terms may be sensitive, but I'd like to understand on what basis asset management services are charged to you and how transparent you feel these charges are:

- i.e. is it clear what you are paying for? What, if anything, is unclear

Do you receive advice / research / analysis on: **FOR EACH – CAPTURE WHO AND WHY**

- overall investment portfolio strategy / asset allocation etc.;
- Selection of equities
- Brokerage / trading of equities
- Voting / engagement / stewardship of assets?

Who is this advice from (e.g.: internal specialists; sell-side analysts / research firms; independent analysts / research firms; investment consultants, proxy voting advisors etc.

- Why do you use these different sources of advice?
- How often do you review / change sources of advice?

(NB: trust based occupational pension schemes **must** receive advice from an appropriately qualified person).

Again, (for each) on what basis are these advisory services charged to you and how transparent do you feel these charges are:

- i.e. is it clear what you are paying for? What, if anything, is unclear

- Are they bundled together with asset management charges or with each other and if so to what extent etc.?

VOTING

How important is it for you to engage with or influence the decisions of the companies whose equities you hold? Why is this important? How / in what ways do you do this?

Are there any particular occasions or topics where you are more likely to want to vote? Why?

NB: Here it would be a good sense of how they feel about voting – i.e. is it something they want to do / have to do / - is it a chore / something they want to hand off to a third party?

What is your organisation's view with regard to exercising voting rights?

Do you ask for voting rights to be passed back to you or do you rely on intermediaries to vote on your behalf? Why? How, if at all, has this changed over the past 10 years? (i.e. is there more felt pressure to vote now than before? – if so, what is driving this pressure)

Are there particular times / occasions when you would want or need certainty over being able to use your voting rights? When? Why? How would you do this?

Do you vote on the UK shares in your fund/trust etc.? How is this done? – e.g. do you vote on your shares directly with CREST or via one or more intermediary?

What is the cost of voting (financial / time etc.? On what basis are you charged? How transparent are the charges? Are these costs bundled together with other charges?

How much time do you spend on voting – either on considering how to vote, speaking with advisers or dealing with other intermediaries?

When you vote via an intermediary, can you be certain that your vote will be counted and that your voting intentions will be followed?

What, if any, measures do you have in place to trace your votes and how they have been voted? Why? Why not?

When advisers, custodians or other intermediaries effectively vote on your behalf (i.e. are not asked to pass back rights) what certainty do you have that they follow your instructions (if you provide these)

- i.e. to what extent might it be possible for a mandatory instruction to become a discretionary power as a result of a chain?

In your view, how transparent is the voting system for UK equities held by institutional investors?

- What, if anything, gets in the way of transparency?

To what extent does the current system allow you to obtain certainty that your vote has been counted and voted correctly?

To what extent does the current voting system allow you to engage with companies in the ways that you would like to?

The Final Report of the Kay Review observes that there is a 'misalignment of incentives throughout the equity investment chain'. It refers to 'an explosion of intermediation in equity investment'. It also points out that 'regulation should focus on the establishment of market structures which provide appropriate incentives, rather than the fruitless attempt to control behaviour in the face of inappropriate commercial incentives.

What are your views on this?

Summary section:

Summarise the chain between the respondent and the company

What or who, in their view, is driving this intermediation?

Are the chains getting longer? Why?

In an ideal world:

- Which bits of the chain do you need to keep?
- Which bits could you improve?
- Which bits could you manage without?

Final Thoughts

THANK AND CLOSE



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