

T2S DIVISION

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SHAREHOLDERS VISIBILITY IN CROSS BORDER ENVIRONMENT

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1. Introduction

On 11 March 2009 the T2S Team organised a conference for EU issuers, primarily of equity securities. The aim of the event was for the Eurosystem to clarify the scope of T2S and discuss the project's impact on issuers and their agents.

The most important topic identified in that conference was the need for issuers to be able to identify their shareholders in a cross border environment. It is evident that T2S per se does not create the problem. This is an existing issue where- and whenever cross border transaction activity is present. However, the creation of a single settlement engine for Europe may intensify the issue due to the expected increase in cross border activity associated with T2S and may thus increase the desirability of a harmonised approach.

In order to further explore the topic, the ECB T2S Team, in cooperation with DG-Markt of the European Commission, organised a focused workshop on cross-border shareholder visibility on 14 October 2009.

The present discussion note aims only at providing background information and structuring the agenda for discussion at this workshop. It presents the issue and includes some of the ideas proposed so far from issuers themselves as a way forward. These ideas need analysis and consideration from all involved parties before any official course of action is followed. As it stands, it commits neither the T2S Team and the Commission nor issuers and their agents to any proposed measure, policy or strategy.

2. Domestic environments

Issuers are interested in identifying the end-investors in their shares for a number of reasons:

- ✓ to register their ownership for legal purposes;
- ✓ to identify investors for the purposes of Annual General Meetings (AGMs);
- ✓ to be able to communicate with them;
- ✓ to analyse investors' behaviour;
- ✓ (for a small number of companies, e.g. airlines) to monitor compliance with restrictions on the nationality of shareholders.

There are a number of different legal structures for holding shares in use across Europe. The process for identifying end-investors depends initially on whether the shares are *bearer* or *registered* and, in the case of registered shares, whether they are registered in the name of the end-investor or in the name of a nominee. Unless the end-investor is registered in his own name, his identification requires a process of working back through the holding chain, the so-called chain of intermediaries. Although several EU member states have a legal framework that gives the issuer the right to effective disclosure by those

intervening in the holding chain, there is currently no EU-wide legal obligation. In some member states, banking secrecy rules or contractual provisions may stand in the way of such disclosure. In many other member states, the law remains silent.

A further distinction can be made between systems where information about shareholders is *flow-based* and those where it is *stock-based*. In the former case, information about the holders of the securities is constantly updated as a result of transaction in the security; in the latter case an analysis of the holders is provided as a “snapshot” on a particular date, which may be triggered either by a specific event (such as an Annual Meeting) or by a request from the Issuer.

The following sections provide a description of the processes in selected EU countries, namely, the UK, Germany, the Nordic countries, France and the Netherlands. More information on other markets would be welcome although one may expect that other processes elsewhere in Europe are broadly covered by the descriptions herein. However, this assumption remains to be validated.

UK

The UK model provides flow-based information at the level of the legal owner (which in many cases is the end-investor), supplemented by the ability for issuers to track through the chain of ownership.

The book entries in Euroclear UK constitute the electronic register, which is constantly updated as settlement takes place. No further intervention from CSD participants is required for registration processes. Euroclear UK provides the details of settled transactions in real time to registrars, who update their mirror register databases. A daily reconciliation is carried out between Euroclear UK and the registrars.

The legal owners who appear on the register may themselves be the end-investors (if they choose to hold shares in their own name) or may be custodian banks or nominee companies, holding the securities on behalf of the end-investor. UK issuers have the right under Section 793 of the Companies Act 2006 (“S793”) to require holders of shares either to confirm that they are themselves the beneficial owner of the shares they hold or to identify the beneficial owner if it is another person or entity. The combination of the ability under S793 to identify the end-investors behind nominee names and the real-time updating of legal ownership information means that UK issuers are able to track changes in the composition of their end-investors with a reasonable degree of confidence.

Germany

The German model provides flow-based information at the level of the registered owner (which may be the end-investor), supplemented by the ability for issuers track through the chain of ownership.

Settlement and registration in the issuer's register refer to two different steps. In step 1, settlement takes place in the omnibus accounts of the clients' intermediaries in Clearstream Banking Frankfurt ("CBF"). In step 2, CBF informs the register, based on information received from the intermediaries, of the identity of shareholders to be registered and de-registered. Thus, CBF coordinates the number of registrations/de-registrations with the number of securities settled on their omnibus accounts. (The beneficial owners information contains legally defined personal data). Only where a client has instructed its bank to act as its nominee (or in the case of proprietary holdings of the bank), will the bank itself appear on the issuer's register. In the case of nominee registration, the bank is legally required to disclose its client upon the issuer's request (comparable to S793).

The messages sent through CBF interfaces use ISO 15022 formats.

Nordic markets

The Nordic model provides flow-based information at the level of the end-investor (for resident investors) and at the level of the custodian (for non-resident investors).

By law, all resident accounts have to be opened at the level of the CSD in the name of the beneficial owner, i.e. the end investor (also known as *direct holding* system). Non-residents are allowed to hold shares through omnibus accounts. The accounts can be operated directly by the issuer or delegated to a financial institution who is a CSD participant. [It is not known whether Issuers have the power to look through the omnibus accounts to identify non-resident end-investors.]

France

Two models exist in France, depending on the type of security:

- flow-based information at the level of the end-investor (for resident investors) and at the level of the custodian (for non-resident investors);

- stock-based information at the level of the end-investor, at the request of the Issuer.

Flow-based information is provided at the level of the accounts kept by intermediaries in Euroclear France ("EF"):

- at the level of beneficial owners (end investors) for French residents - imposed by French account keeping rules;

- with the possibility of nominee position registration under omnibus accounts for non resident positions (individualised positions are of course allowed and encouraged but rarely done by foreign global custodians).

The messages are sent to the issuer by a STP through EF. Proprietary (BRN) and not ISO messages are used during the process. It should be noted that there exist also registered securities that are not circulated on the books of the CSD (*nominatif pur*) and that are not subject to this process.

Stock-based information is provided when an Issuer sends a request for shareholder identification to the CSD (EF). EF forwards the request to its participants (intermediaries) with holdings in the relevant ISIN. Each intermediary provides detailed identification of all shareholders as maintained in its books with the quantity of shares held in the relevant ISIN. Thus identification is at the level of the beneficial owner for French resident holdings and the holder of omnibus account, designated as registered intermediary (*nominee* or *trust* etc) when non-French resident holdings are concerned. It should be noted that some intermediaries holding omnibus accounts provide the details of their clients holding through such account in order to facilitate the identification process.

Issuers can further investigate omnibus accounts holdings using either the TPI (Titres au porteur identifiable) 2nd level as proposed by EF¹ or using the provisions of the French Commercial Codes that stipulates that the registered intermediary is bound to communicate information on request of issuer. Enforceability of these possibilities remains an issue.

The Netherlands

A stock-based system of shareholder identification at the time of a company's General Meeting is being introduced in the Netherlands in 2010.

Legislation has been introduced in the Netherlands to take effect at the start of 2010. Up to 60 days before its General Meeting, an issuer will be entitled to obtain information from any intermediary on the names and addresses of its shareholders in the books of that intermediary. This information must be provided within two days.

Euroclear Netherlands has proposed that it could fulfil the role of central processor of issuer services in the Netherlands².

Thus it can be seen that at least in the UK, Germany, France, and the Netherlands legislation enables issuers to request from intermediaries disclosure of underlying shareholders (end investors) which goes

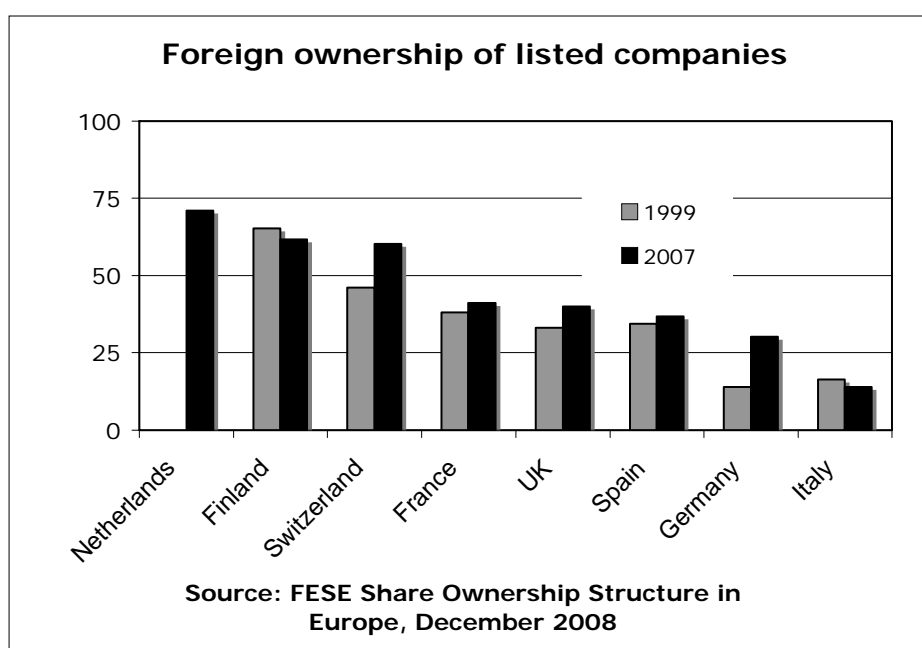
¹ TPI: Procedure put in place by the French CSD to identify the beneficial owner

² See https://www.euroclear.com/site/publishedFile?DocumentName=ENL001_Issuers%20shareholders%20whitepaper_tcm88-168208.pdf&action=dload

beyond the aggregate holdings normally maintained at CSD level. However, the enforceability of such disclosure obligations varies across markets. Furthermore, the process for disclosure is paper based, non STP and very costly for issuers, intermediaries and CSDs.

3. Cross border environment and T2S impact

Increased cross-border investment and trading has been a long-term trend. The chart below shows that in a selection of European countries the percentage of non-resident shareholders in listed companies grew between 1999 and 2007; in two countries there was a small reduction.



Issuers understand why this is desirable, as foreign investors help sustain their growth and reduce their cost of capital. Indeed, for many companies diversification of their shareholder base is a key objective for their investor relations programme.

This trend has, however, resulted in longer and more complex chains of intermediation. Today, end-investors frequently hold their investments through intermediaries who in turn hold foreign securities in omnibus accounts through custodians who are domestic participants in the issuer CSD. Thus, there may be two or more intermediaries between the end-investor and the issuer. The complexity and risks associated with CSD links mean that intermediaries often prefer to use an omnibus account with a direct participant in the issuer CSD rather than the cross border services offered by their (investor) CSD³.

³ Issuer CSD is where the securities are issued. The issuer CSD typically maintains omnibus accounts in its books in the name of another CSD (investor CSD). A CSD may act as Issuer CSD for one security and as Investor CSD for another.

If the UK market is taken as an example, the powers under S793 work effectively only for the identification of beneficial owners holding securities through domestic custodians. An issuer's ability to receive satisfactory responses concerning beneficial owners domiciled in foreign jurisdictions is very limited. In addition, there are no standard data formats used across EU, with the result that cross-border communication is frequently a manual process, even when foreign custodians are willing to comply. As a consequence, the domestic shareholding is transparent to the issuer either because beneficial owners are registered in the share register or because they can easily be identified by means of S793, whereas foreign shareholders are registered only through omnibus accounts of nominees. This hinders issuers in communicating effectively with their investors and hinders shareholders in exercising their voting rights.

The trend to greater cross-border investment and trading is likely to continue. T2S is likely to support this development – indeed, part of its objective is to make cross-border trading and investment easier within Europe – but by itself does not necessarily make this situation any worse. However, the introduction of T2S will most probably result in various changes to the current securities holding structures.

- In some cases, investors may choose to use direct links between CSDs as these become more efficient, with the result that a foreign CSD is more likely to appear on a company register as the holder of an omnibus account.
- In other cases, intermediaries may choose to become direct participants in foreign CSDs themselves, rather than using local custodians, in which case the chain of intermediaries will become shorter.

It is notable that both options are already available to intermediaries today, but little used. One can justifiably expect that the introduction of a single settlement engine in the EU will foster connectivity and interoperability. Harmonisation of market practices will also work in the same direction. See the current development in the work of CESAME2, Corporate Actions Joint Working Group (CAJWG), General Meetings Joint Working Group, T2S harmonisations subgroups on Corporate Actions and Process Efficiency.

The issue has been raised whether the existence in the future of a single platform maintaining the securities accounts of all European issuers may offer the potential for a simpler means of achieving transparency between investors and issuers. Even if such potential should exist, in the absence of a common legal framework and harmonised market practices, this potential will not be achieved. In addition one should keep in mind the predominance of indirect holding systems in Europe's largest markets as well as the omnibus accounts used for cross-border holding even in direct holding markets. T2S could in theory identify those CSDs that hold a respective ISIN, as well as the relevant CSD participants, but transparency as to the end investors behind these holdings will not be available to T2S under current state of affairs.

3. Questions for workshop discussion

A number of questions have been raised by issuers in relation to the increased market connectivity developments:

1. To the extent that more shares are held across CSD links, what level of information will the (non domestic) Investor CSD provide to the domestic issuer and how? What system or process will be used to provide such information? Via a domestic system (issuer CSD process) or a harmonised T2S feature?
2. Does the Investor CSD status of being a “participant” of the Issuer CSD (but not a financial intermediary, at least not in all cases) impact the Issuer CSD’s ability to provide the registration information to domestic issuers? How is this different from the traditional participation of a custodian bank in the Issuer CSD?
3. To which regulator will the Investor CSD report? What will be the Investor CSD’s local obligations (if any) in terms of registration processes? How will they be enforceable by issuers who have links only with their domestic regulator?
4. Would non-UK issuers welcome the adoption of a procedure similar to S793 in their domestic markets?
5. Regarding France and Germany: will all shares held for the accounts of Investor CSD participants be registered under the Investor CSD’s name or will the Investor CSD provide detailed registration at the level of its participants or at the level of the participants’ clients accounts and translate it into the registration language of the Issuer CSD?
6. Would it not it be profitable for the market to harmonise the registration language? What are the volumes of registration messages exchanged today across Europe? How many disclosure requests are made by issuers? Is it worth harmonising?
7. What about electronic voting forms? (See CESAME standards on AGM)

4. Options for discussion

Following the 11 March 2009 Issuers conference, the following proposals have been put forward by the respondents to T2S Team as potential solutions for the questions raised in the previous section.

4.1 End Investor Model

In the context of T2S, one issuer challenges the necessity to keep a model allowing omnibus accounts at least for EU holders. As in the Nordic markets where the obligation is to segregate CSD accounts at the level of resident (end-investor) beneficial owners, would it not be an option to extend this obligation to all EU residents and markets? Omnibus accounts could still be allowed for Non EU residents.

There is an ongoing initiative in Europe on the possibilities for harmonising account structures in CSDs. Bodart-Frey chaired teleconference on 7 Sept 2009.

4.2 Process S793 in UK and beyond

UK Issuers wish the S793 process to continue to work effectively, so that when S793 notices are issued to a non domestic Investor CSD or to non domestic intermediaries (nominees), responses are as prompt and as accurate as they would be from a UK nominee.

As a result, UK issuers and their agents propose as a minimum that CSDs joining T2S be required to undertake to respond promptly to S793 requests received from UK issuers providing details of holdings within that CSD (in their capacity as Investor CSDs for UK securities).

In principle such a request cannot be a pre-condition for T2S participation, since this would violate the legal and regulatory independence of participating CSDs. If such legal basis should come into existence, it will apply as a matter of law and not as requirement set by T2S.

4.3 T2S, Legal Certainty Group and Shareholders Rights Directive

Responders have raised the relevance of the SRD and the work of the LCG in this debate:

The Shareholder Rights Directive (SRD) governs the rights of shareholders in listed companies and establishes requirements in relation to the exercise of certain shareholders rights attached to voting shares in relation to general meetings of listed companies. Only in this context, being the “rights of shareholders” holdings through intermediaries, the Directive recognises disclosure requirements as a prerequisite for the exercise of voting rights (Art 13). However, the Directive does not provide for a harmonised right of issuers to have their shareholders identified.

The recommendations of the Legal Certainty Group (LCG) of the European Commission also address in Recommendation 13 the exercise of rights by investors (beyond the scope of the SRD). There is however

no indication that the Group wished to address the issue of shareholders transparency, neither through a specific rule nor by way of cross-border recognition of disclosure requirements.

Accordingly, the recent public consultation document issued on 16 April 2009 by the European Commissions ('Legislation on legal certainty of securities holding and transaction'), based on the recommendations of the LCG, did not ask for any views on shareholders transparency.

4.4 T2S in shareholder information dissemination

A number of proposals have been put forward from the respondents on the technical role of the T2S platform in facilitating dissemination of beneficial owners information to EU registrars and issuers. These proposals are made with no reference to the legal obstacles/barriers for usage and distribution of such information within the CSDs connected to T2S. EU Legal harmonisation in this area is a prerequisite for any technical solution in the T2S IT platform. An additional constraint would be the degree of availability of such end investor information to all T2S CSDs.

The proposals include:

- T2S can be used as an instrument in improving dissemination of shareholders information. One market response suggests a mini-consultation about a wide range of issuer related questions during this year after the Commission proposal on the new legal framework for intermediated securities has been published.
- Cross-border communication of shareholder data is essential for further facilitating cross-border exercise of shareholder rights and effective investor relations. It would be very helpful to find a standardized data model for shareholder information and share register information in Europe. T2S could then serve as a pan-European platform for the exchange of such shareholder data. A suggestion would therefore be to establish a standardized set of shareholder information for the CSDs in Europe which would enable them to communicate through a standardized interface as part of T2S. As the exchange of shareholder information for the share register is part of the settlement process, T2S would be the perfect platform to support such processes.
- T2S could for example make it a requirement that the registration message (via the CSDs) to the registrar or issuer should include details of the account (beneficial owners information) within the CSD and not just the CSD nominee positions. This would be equivalent to today's situation for German issuers.