

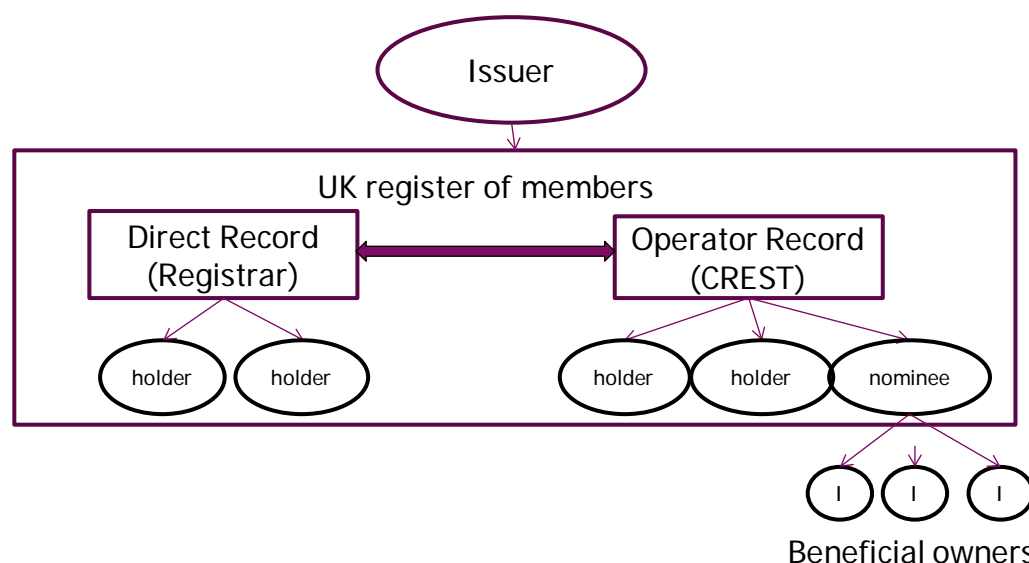
Proposed Structure of Dematerialised UK Share Registers

For the purposes of further discussion with HMT, BIS and the FSA on the issue of dematerialisation, The Registrars Group has prepared a high-level outline of how a UK share register could be structured and administered in a fully dematerialised environment. This approach reflects and addresses the “Dematerialisation Principles” agreed by the Registrars Group and enclosed as an appendix to this document.

1. Dematerialised UK Register Structure

We believe a central principle of implementing dematerialisation in the UK must be the preservation of key elements of the existing share registration model, while nonetheless delivering on the efficiencies of shareholdings in electronic form. We therefore envisage a model with the following high-level structure:

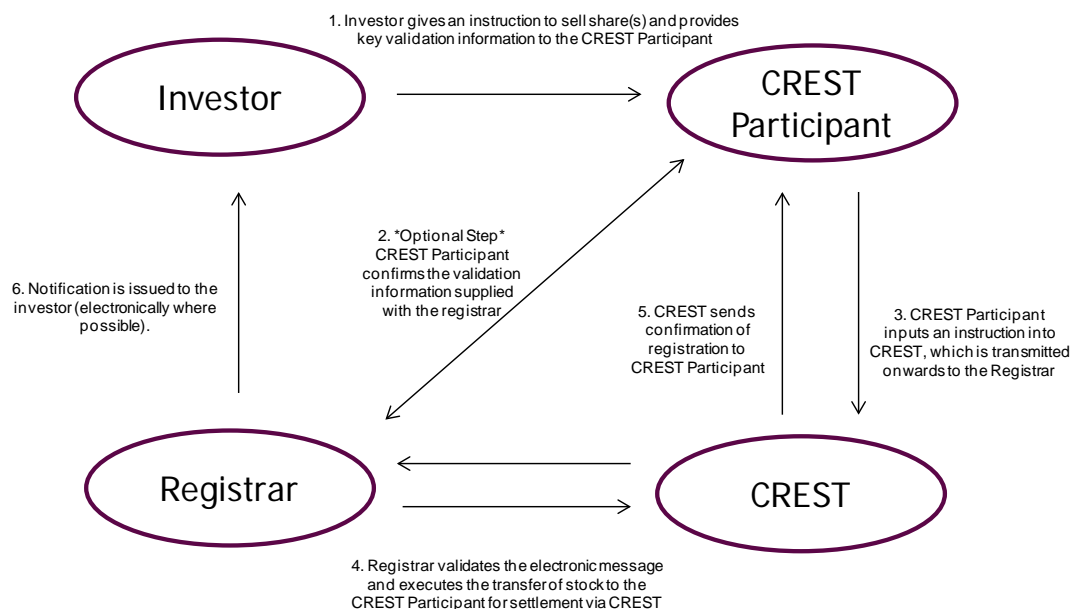
- › The issuer's total register of members would continue to comprise two distinct components:
 - 1) The Direct Record; and
 - 2) the Operator Record (CREST).
- › The Direct Record would be the equivalent of the current certificated part of the Register, albeit in book entry form. The Operator Record would remain in its current form, as administered by Euroclear UK & Ireland, with full legal title as part of the total register of members.
- › The issuer would continue to have ultimate responsibility under UK company law for the whole register of members.
- › Shareholders would continue to have the option of holding their shares on either component of the register.
- › The shareholdings registered on both these components of the register will continue to benefit from direct legal title, direct shareholder communications and direct exercise of shareholder rights, whilst preserving a transparent ownership structure viewed as beneficial for engagement and corporate governance.
- › **Corporate Actions** - The administration of corporate actions in terms of information flows and instruction flows will remain largely unchanged.



2. Interaction between the Register components for Settlement

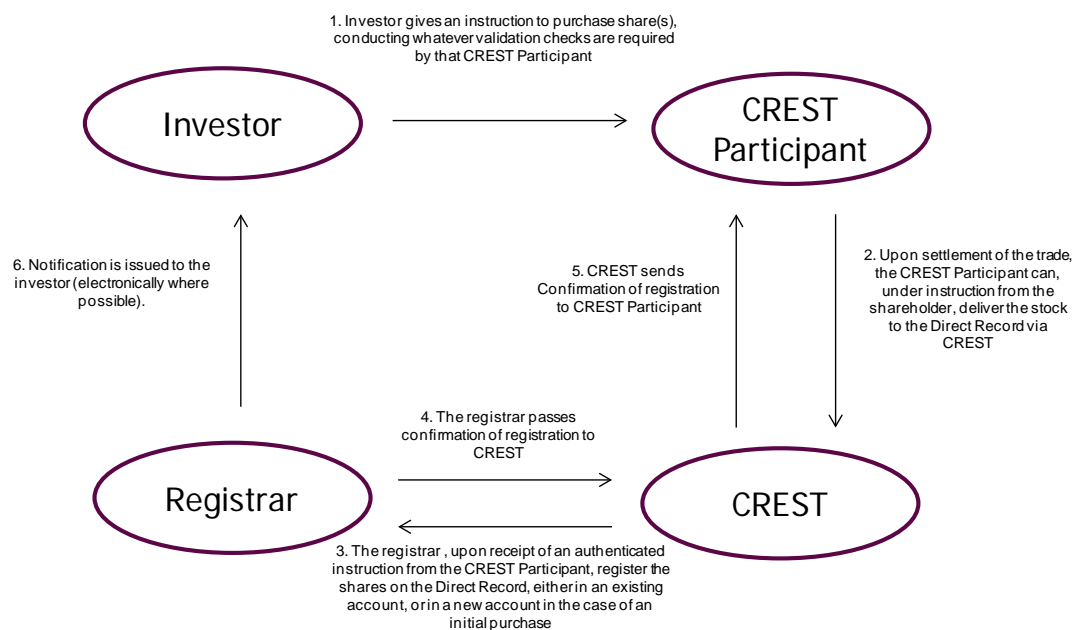
To obtain the full benefits of a dematerialised environment, an efficient mechanism should exist between the Direct Record and the CREST (Operator) Record, for the purpose of moving shareholdings between the two separate components of the Register of Members.

- › For example, this would be used to transfer shares efficiently from the Direct Record to a CREST Participant's account on the Operator Record to facilitate settlement of sales entered into by holders on the Direct Record; or to move purchased shares from the CREST Participant's account into the name of the buying shareholder on the Direct Record.
- › We would suggest that such movements should be capable of being handled in a streamlined, electronic/efficient manner so far as possible to enhance efficiency. This would need to be supported by appropriate rules in terms of responsibility and liability for the share movements.
- › The market should consider using this mechanism to replace the existing CREST Counter for administering the transfer of certificated shares into CREST.
- › Registrars may offer a facility to support the sales process which would allow brokers the ability to validate an investor's holding on the register, dependent on their appetite for risk. This interface could comprise various forms, to be determined by the Registrar e.g. direct electronic interface, internet, telephone, paper etc
- › The following diagram provides an example for how a shareholder on the Direct Record could arrange with a CREST Participant to sell their shares, with settlement taking place in CREST.



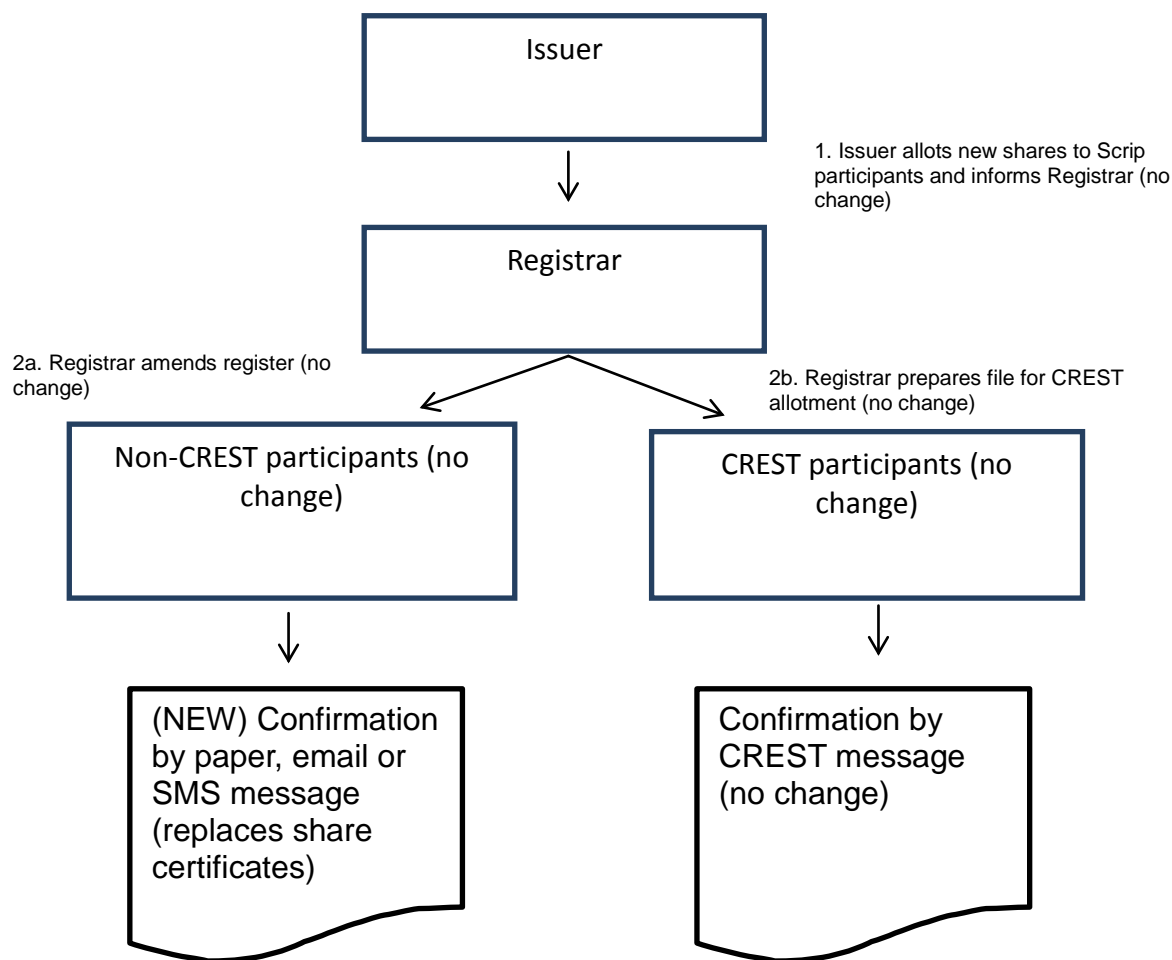
- › We do not envisage that this would result in any changes to current requirements for settlement finality. Settlement will continue to take place in CREST, and transfers of title administered on the CREST Operator Record would continue to be effective under current rules, as part of the register of members of the issuer.

- › An investor purchasing shares would be able to instruct their CREST Participant to transfer their shares from the CREST Participant account at CREST to be held directly in the investor's name on the Direct Record, as shown below:



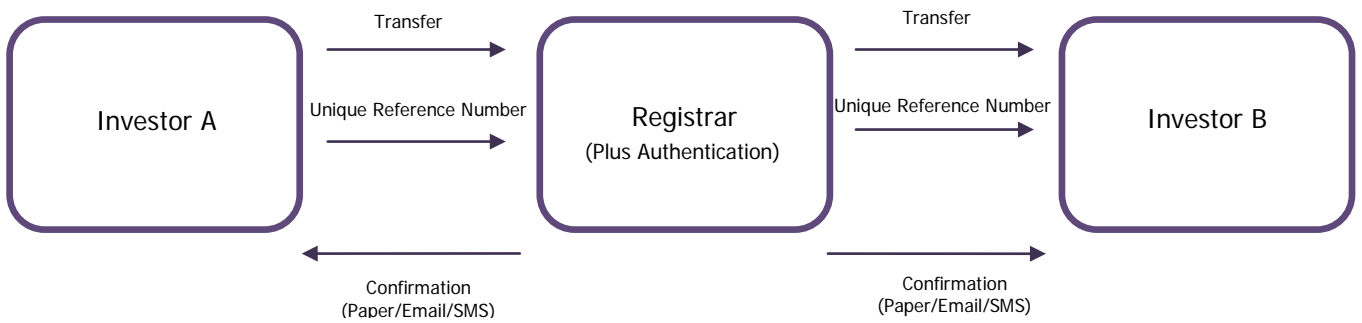
- › There are inefficiencies in the existing model where valuable information is not captured relating to purchase. This can enable validation and additional forms of security when holders perform further transactions. As part of the holder information provided by CREST Participants in the message withdrawing stock from CREST onto the Direct Record, CREST Participants should include security information and cost saving information. For example, the holder email address, their mobile telephone details and bank mandate details for the payment of dividends. Supporting law should allow the issuer (via their registrar) to use this email address/mobile telephone number for electronic communication.

3. Issuance of securities (using a Scrip Dividend as an example)



- › The above diagram provides an example of the possible flow for a new issue of securities, based on the example of a Scrip dividend. Changes to the current processes for an issuance of securities of this nature have been highlighted.
 - › When an Issuer allots new shares as part of a Scrip dividend, the dematerialised shareholders receive confirmation of allotment. CREST participants are unchanged.
4. Off Market Transfers
- › The diagram below provides an example of an ‘off-market transfer’ of shares i.e. a transfer from one shareholder to another on the Direct Record. Such transfers may arise e.g. from a gift of shares, transfer to beneficiaries of a deceased holder etc. This highlights the key process flows and does not address issues such as stamp duty assessment, which we would anticipate being unaffected by a move to dematerialisation.
 - › This diagram presupposes certain details that will need to be the subject of further market discussion in relation to how dematerialisation is implemented in the UK. We have sketched these out at present simply for the purposes of illustrating the possible transaction flow.
 - › We recognise the need for some form of additional security measure in the absence of having certificates as cover for Off Market Transfers. This could potentially be achieved through the issuance of a unique reference number or dematerialised reference number (issued by the Registrar) to shareholders, as well as other security information, as detailed above, used to authenticate transactions entered into on their behalf.

- › The transferee may complete a Stock Transfer Form or, for example, use a secure website for paperless transfer. The registrar, acting on behalf of the issuer, may require additional authentication before completion of transfer (for example, this may include identity and address confirmation, potentially above a certain value). Both transferor and transferee receive confirmation of transfer (frequency and method to be confirmed).



5. Corporate Actions

Although flows and information should remain largely unchanged, further analysis needs to be performed on Corporate Actions to agree how to replace the role of the certificate in events such as takeovers (especially contested ones), rights issues etc.

Appendix 1 – Dematerialisation Principles

Dematerialisation Principles

Principles

We believe that the following core principles apply in relation to how the UK market should approach the debate and decisions concerning the dematerialisation legislation/directive in the context of a registered share market:

1) Registered shares.

The UK (and Irish) markets obtain great benefit and efficiency from its registered share structure, made up of the Direct Record and the Operator Record components. The legal basis and structure of the registered model of ownership must be preserved. This is a central feature of our market structure that benefits shareholders and issuers, as well as facilitating market efficiency.

2) Dematerialisation must produce benefits.

There is some acceptance that dematerialisation could be positive for the UK retail market, delivering greater levels of efficiency and resulting in the modernisation of many aspects of direct securities holding and registration, provided a suitable model can be agreed. In particular, appropriately structured, it would provide solutions for the problems caused by lost certificates (especially with banks and financial institutions becoming ever more reluctant to join in on certificate indemnities); reduce potential fraud relating to paper certificates; and should reduce the time taken to settle a trade which, in turn, would reduce market counterparty risk.

3) Any book entry model adopted must be the best for each market.

Adopting a stance of asking the Commission not to legislate in this area does not appear to be viable, or necessarily in the long term interests of the efficiency of the UK or other European markets. However, given the different market structures and different historical processing there is no 'one size fits all' solution that would be acceptable to all markets. It is essential, therefore, that the Commission allow Member States full discretion to determine the most appropriate model for dematerialisation, based on local considerations.

4) Shareholder Rights must be protected.

A danger within a number of potential models is that retail investors who have name on register today and hence receive direct voting rights etc could be forced into an intermediated model e.g. as is the case in France where dematerialisation is exclusively within the CSD. Any model introduced should protect shareholder rights.

5) Issuer Rights must be protected.

As more demands are placed on issuers in relation to governance, protocols and shareholder engagement any dematerialisation system must ensure there are no legal, structural or operational barriers inherent in the model. Specifically, any model that reduced shareholder transparency or reduced current efficiency around shareholder communications, voting, or dividends or other corporate actions would be considered a regressive step by issuers (and investors).

6) Efficient Structure.

Any future model for delivering dematerialisation in the UK needs to be focused on market efficiency and direct (ideally electronic) communications. It also needs to be characterised by

having strong legal underpinnings (minimal changes to existing legislation where possible) and an appropriate level of security and fraud prevention measures. A model with such characteristics would have the potential to deliver long term savings to UK issuers and more effective relationships with their shareholders.

7) Benefits must outweigh costs and costs should be apportioned in a fair and balanced way.

The model must provide long term benefit to the market and its users, particularly issuers and investors, even if it involved costs in establishing the model.

8) Logical and measured transition plan.

The appropriate transition/implementation timescales for a future dematerialised holding structure should be considered carefully. An indefinite period of grandfathering, during which any new structure only applied to newly issued securities, would be damaging for market efficiency, leading to a two tiered structure, with disadvantages for existing securities vis a vis new companies coming to market. The maintenance of multiple systems required to service a two tiered structure would add significant cost for the market and would stifle new service innovation. At the conclusion of a short transition period, the system should be mandatory for all publicly listed issuers and their investors.

9) The market should consider all dematerialisation options, provided that they meet the criteria presented above.

Whilst we should be adamant that the EU allows markets to determine their own models, we should not disregard consideration of any model at this point that meets these criteria (e.g. the model of allowing only dematerialisation through a CSD would not meet these). The UK market should also be open to learning from other systems in other international markets beyond Europe¹.

Proposal for moving forward

Once the market has agreed on a core set of principles, such as those outlined above, what are the next steps?

1. We have requested that the government takes a proactive stance in relation to European lobbying on this issue, driving the agenda and ensuring that the UK market benefits from the upcoming legislation/directive, rather than be hampered by it. In the short term this means ensuring any wording and timetable determined by the EU satisfies the principles above (including by removing any language that constrains any dematerialisation system exclusively to the records of the CSD); and
2. We have requested that HM Treasury and/or the Department for Business Innovation and Skills (as appropriate) sponsor the formation of a cross market group to make recommendations on a model and market structure that meets the requirements of the upcoming legislation/Directive, whilst retaining the valued characteristics of the

¹ Models exist in a number of other international markets, which are similar to the UK in being 'name on register' markets, that are likely to offer many of the desirable core characteristics that are central to what the UK market should be looking to retain in any future model. These include, for example, the 'name on register' approach and direct communications between issuers and shareholders, robust systems of reconciliation and control, an efficient transfer and settlement infrastructure and a managed balance between market efficiency and security.

UK registered share model and characteristic high levels of efficiency. We suggest that this cross market group would benefit from also incorporating representatives of the Irish market, which has the same broad issues/concerns.

Whilst we would prefer the UK and Ireland to be able to choose when dematerialisation is implemented we would accept mandatory dematerialisation from the EU provided these agreed principles are adhered to and the EU regulation allows sufficient scope for each member state to determine the appropriate model for implementation of dematerialisation.