Consultation on expanding the dormant assets scheme: response sheet

RESPONDENT INFORMATION

Respondent(s) *When responding, please state whether you are responding as an individual, or on behalf of an organisation, multiple individuals or multiple organisations. Joint responses with like-minded stakeholders are encouraged. If responding on behalf of multiple individuals or organisations, please make it clear who you are representing and, if applicable, how their views were assembled.*	This response has been prepared on behalf of the City of London Law Society (CLLS) by a working party comprising members of its Company Law Committee. The CLLS represents approximately 17,000 City lawyers through individual and corporate membership, including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees.
Sector (if applicable)	Private **IF PRIVATE**, please also indicate the subsector(s): Other (legal services)
Future contact *May we contact you to discuss your response to this consultation, if necessary?*	Yes If yes, please provide your contact details: Robert Boyle +44 (0)20 7849 2863 robert.boyle@macfarlanes.com
Date *Please ensure your response is received before 23:59 on 16 July 2020.*	8 July 2020

RESPONSES

PLEASE NOTE: If you leave a response blank, we will take this to mean that you have no comment on that question.

1. **Do you have any comments on the proposed scope of assets in an expanded scheme (subject to ensuring tax neutrality)?**

Question	Response (delete as applicable)	Comments
1	YES	Our comments throughout this response are limited to the proposed expansion of the dormant assets scheme as it would apply to dormant share proceeds and other dormant security distributions. We make no comment on the expanded scheme as it would apply to bank and building society accounts, insurance policy proceeds, unit proceeds or investment asset proceeds or distributions, as that is considered beyond the scope of the City of London Law Society Company Law Sub-committee's remit.

2. **Do you have any comments on the proposed definitions of assets?**

Question	Response (delete as applicable)	Comments
2	YES	**General comments** We note that the consultation paper refers to “dormant share proceeds” and, separately, “other dormant security distributions”. In relation to the second of these categories, the consultation paper refers to “dividends and proceeds from corporate actions” and specifically mentions consideration payable under section 981(6) of the Companies Act 2006 (the “**CA 2006**”) (i.e. on a statutory “squeeze-out”) or under a scheme of arrangement under Part 26 of the CA 2006. We recognise that the consultation paper does at this stage not seek to be comprehensive as to the kinds of proceeds that would fall within the regime. However, as a general point, we consider that there are various other types of proceeds that would need to be considered and placed within the appropriate category. These include (without limitation): • Proceeds from share redemptions and buy-backs. • Repayments of capital following a reduction of capital. • Proceeds from sales of fractional entitlements to shares arising from a rights issue. • Proceeds from the sale of a provisional allotment letter (PAL) on a rights issue. • Further shares issued by way of scrip dividend or bonus issue. • Proceeds payable under a scheme of arrangement under Part 26A of the CA 2006. • Proceeds payable under a statutory merger under Part 27 of the CA 2006. • Distributions to shareholders on a winding-up. We would encourage the Government to define “dormant share proceeds” and, separately, “other dormant security distributions” in detail in any draft legislation so that it is clear into which category each of the kinds of proceeds described above falls. (We note that a shareholder may also be entitled to proceeds as part of a cross-border merger under the Companies (Cross-Border Mergers) Regulations 2007. However, given that, as things stand, the cross-border mergers regime will no longer be available in the UK from 1 January 2021, we assume that the

		scheme will not be expanded to cover these kinds of proceeds.) **Shares subject to the expanded regime** In the table in paragraph 2.1.2, the consultation paper refers to shares in "UK-registered PLCs as defined in section 4 of the Companies Act". However, later, in paragraph 2.1.7, it refers to public limited companies "whose shares are listed on the London Stock Exchange". We would note that section 4 of the CA 2006 encompasses both public limited companies ("**PLCs**") whose securities are traded on a securities exchange (and so are likely to be readily realisable) and "unlisted" PLCs[1], which are more akin to private companies and whose securities are not publicly traded. We see no compelling rationale to include "unlisted" PLCs within any expanded regime for the following reasons: • In many cases, there is no ready market for securities in an "unlisted" PLC, meaning they may not be readily converted into cash for contribution to an ARF. • Public prices are most unlikely to be quoted for an "unlisted" PLC's securities, making valuation difficult or impractical for the purposes of the regime. • Securities in "unlisted" companies are often subject to restrictions on the transfer of those securities, either in the company's articles of association or in a private contract, leading to difficulties in realising the value in those shares. We would therefore recommend that, for the purposes of the regime, "shares" be defined by reference to publicly traded PLCs. (See our response to question 8 below for further comments on this.) **Other dormant security distributions** The consultation paper refers to "dividends, as defined in section 829 of the Companies Act". However, section 829 of the CA 2006 refers to "distributions", of which dividends are one kind. Any concepts that are defined by reference to the CA 2006 should be drafted using language consistent with that in the CA 2006.

[1] By this we mean a PLC whose securities are not admitted to trading on a securities exchange, rather than a PLC whose securities are not admitted to the Official List maintained by the Financial Conduct Authority.

		Non-cash proceeds In most cases described above, the proceeds from a share or a corporate action can include non-cash assets. Examples include further shares of the same class or shares of a different class, shares in a different legal entity, loan notes, debentures and other types of financial instrument. In particular, the proceeds could comprise “unlisted” securities. We do not consider that it would be appropriate to transfer these kinds of asset directly into an ARF and so presumably they would need to be realised for cash before any contribution can be made. In order to avoid any uncertainty, and to protect ARFs from receiving assets of this kind, any expanded dormant assets regime should, in our view, either exclude non-cash assets or set out how they are to be treated for the purposes of the regime. As noted above, in our view, there are significant difficulties involved with including “unlisted” securities within the regime. **Other comments** • In the context of a statutory “squeeze-out”, section 982(4) of the CA 2006 requires a company to pay any unclaimed proceeds into court. This requirement would need to be amended, or a new procedure included, to allow the company to pay the proceeds instead to an ARF. • See below for our comments on which assets would need to be included within the expanded scheme where shares are held in an intermediated structure.

3. **Are there alternative ways of defining the assets?**

Question	Response (delete as applicable)	Comments
3	YES	We have no specific comments on this question, but we would note that there may be merit in considering whether, for the sake of consistency, assets should be defined by reference to terms defined in the EU Markets in Financial Instruments Directive (MiFID II) or the EU Market Abuse Regulation (MAR).

4. **Do you have any objections to <u>excluding</u> insurance products that do not crystallise to cash from an expanded scheme at this time?**

Question	Response (delete as applicable)	Comments
4	NO	We make no comment on this question.

5. **Do you have any objections to <u>excluding</u> pensions from an expanded scheme at this time?**

Question	Response (delete as applicable)	Comments
5	NO	We make no comment on this question.

6. **Are there any other assets that the government should consider for inclusion in an expanded scheme?**

Question	Response (delete as applicable)	Comments
6	NO	We make no comment on this question.

7. **Do you have any comments on the proposed definitions of dormancy?**

Question	Response (delete as applicable)	Comments
7	YES	**Defining “transaction”** The consultation paper defines dormancy as a period of time within which no “transactions” are carried out in relation to the relevant asset. Where the asset is shares or other securities, the legislation will need to define what exactly is meant by “transaction”, including what actions beyond merely buying and selling securities

		constitute a transaction. In our view, actions that might warrant consideration include exercising voting rights attaching to the securities, taking up rights under a pre-emptive offer (such as a rights issue) or taking affirmative action to claim a dividend or other distribution. However, the legislation will need to ensure that powers under the expanded scheme would not unfairly disenfranchise shareholders who have adopted a passive investment strategy. It is perfectly conceivable that a shareholder will acquire shares or other securities with the intention of holding them (passively) for a long period of time without exercising voting rights. It would obviously be inappropriate for shares held by such investors to be subject to forfeiture under the scheme. We would therefore recommend that merely refraining from exercising voting rights should not by itself be an indication of dormancy. In addition, there may be companies that determine not to pay, or are unable to pay, dividends on a regular basis. To the extent that non-receipt of dividends is to be an indication of dormancy, we would recommend that, for a particular shareholder, the 12-year period begin from the date on which that there is a failed attempt to pay a dividend, distribution or other proceeds to that shareholder. This would ensure that persons who hold shares in a company that has not paid dividends for a significant period of time are not unfairly denied their property rights. **Intermediated securities** It is common for shares in a publicly traded company to be held via one or more intermediaries. For example, the shares may be registered in the name of a nominee or custodian which holds the shares on trust for the "underlying shareholder" (or beneficial owner). In some cases, there may be both a custodian and a nominee, with a trust between those two persons and a "sub-trust" in favour of the underlying shareholder. In these cases, any voting rights attaching to the shares would be exercisable by the registered shareholder (i.e. the custodian/nominee), which may exercise those voting rights on a discretionary or non-discretionary basis. Likewise, any dividends, distributions or other proceeds would be payable to the registered shareholder (and then accounted by it to the beneficial owner), and, from the company's perspective, it is the registered shareholder which would transact in the shares (albeit on the beneficial owner's behalf). The company will have no direct contact or legal relationship with the "underlying

		shareholder". Indeed, most articles of association expressly provide that the company is not required to recognise any trust. Nominees and custodians tend to be companies owned by or affiliated with large banking and investment management groups. It is highly unlikely that these nominees and custodians will ever be uncontactable or fail to claim dividends, distributions or other proceeds from securities. In this context, it is therefore without meaning to talk about "reuniting the asset with its owner", as the owner will be the nominee/custodian. Further, where shares in a company are held through a nominee or custodian, it is common for the nominee/custodian, where possible, to match any trades in those shares by its own clients internally in its own books without buying or selling shares in the market. By this method, underlying shareholders are able to sell and acquire investments, but there is no formal/external transaction in the shares in the publicly traded company. Again, the legislation will need to make sure that the shares are not considered "dormant" merely because they are traded in this way. In our view, the legislation will therefore likely need to account specifically for intermediated shares by some other method. See our response to question 8 below. **"Reasonable and proportionate efforts"** See our response to question 10 below.

8. **Do you have any comments on the proposed scope of participants in an expanded scheme?**

Question	Response (delete as applicable)	Comments
8	YES	**Intermediated securities** As noted in our response to question 7, securities issued by publicly traded companies are often held by a nominee/custodian through an intermediated structure. As the proposal in the consultation paper stands, the "participant" in relation to shares in a publicly traded company would be the company itself. For the reasons given in our

		response to question 7, the company may not be able to use the scheme in relation to shares held in an intermediated structure, as the registered owner will almost always be directly contactable (and the intermediary may not allow that “link” to be made). In particular, because the company and the “underlying shareholder” have no legal relationship, the company will not be able to take any action under the expanded scheme if the underlying shareholder has “gone away”. It seems to us that, in an intermediated structure, the asset that is subject to the scheme would need to be the interest held by the beneficial owner. If the traded shares are held within some kind of unitised structure, it is possible that the beneficial owner will hold a security representing their interest in the share (such as a unit). If they are not, the asset held by the beneficial owner will be either an equitable interest in the shares themselves (where there is only one intermediary in the structure) or an equitable interest in the property comprised in a sub-trust (if there are two or more intermediaries), which will itself be an equitable interest in shares or in the property of another trust. Furthermore, in order to realise that asset, the participant in the scheme would need to be the nominee or custodian that has the legal relationship with the beneficial owner. In turn, this will require consideration of how the definition of “dormancy” should apply to such a participant; and by what procedure the asset is to be realised (forfeiture being unavailable to such a participant). It may be that, where the asset in question is securities, the nominee/custodian would be a participant in the expanded scheme by virtue of being an investment management company. Likewise, if the asset in question is cash proceeds from securities (and so is held in a “cash park” within an investment account), the nominee/custodian might conceivably be a participant in the expanded scheme by virtue of being a bank. However, there will be circumstances where a nominee/custodian acts purely as a bare trustee for the purpose of holding legal title and does not provide investment management or banking services. In these circumstances, the legislation will need to clarify that the nominee/custodian is able to forfeit the equitable interest held by the beneficial owner for the purposes of the scheme. This may, in turn, depend on the

		nominee's/custodian's powers in the relevant nominee/investment agreement. **"Public companies"** The consultation paper proposes that public limited companies would be able to participate in the scheme if their "shares are listed on the London Stock Exchange". (We have assumed that the reference to "listing" here is to admission to trading, rather than listing on the Official List maintained by the Financial Conduct Authority.) First, it is unclear to us whether the reference to "London Stock Exchange" is intended to refer only to the Main Market, or whether it is to include other markets operated by London Stock Exchange plc, such as the market known as AIM, the High Growth Segment, the Specialist Fund Segment and the Professional Securities Market. Second, it is also unclear to us why participation in the scheme should be limited to companies admitted to a market operated by the London Stock Exchange. Other markets exist in the UK, such as the AQSE Main Market and the AQSE Growth Market. We would recommend that the definition of public limited company for these purposes be aligned with a category of trading company already recognised, or by reference to categories of market already defined, in UK legislation. It seems to us that the expanded scheme should be capable of applying whether the company is admitted to trading on any exchange where securities are readily tradable. On that basis, we would suggest that the Government consider legislating to include as a minimum all companies whose shares are admitted to trading on a "regulated market" or a "multilateral trading facility" in the UK as participants within the expanded scheme. Moreover, in theory, there seems to us to be no reason in principle why a company whose shares are admitted to trading on a securities exchange outside the UK could not participate in the scheme, so long as that exchange provides sufficient liquidity in the company's securities. If the expanded scheme were to cover these kinds of company, the legislation would need to prescribe which overseas markets qualify for these purposes. There are various existing parameters that could be used alone or in combination (for example, regulated markets within the European Economic Area, markets listed in Schedule

		1 to the Register of People with Significant Control Regulations 2016, markets classified as "recognised overseas exchanges" by the Financial Conduct Authority). Relatively few UK companies are admitted to trading on a non-UK market and not on a UK market, so the Government will need to weigh the advantages of including these companies within an expanded scheme against the time and resource required to frame the scheme appropriately.

9. **Do you have any comments on the proposed reclaim values?**

Question	Response (delete as applicable)	Comments
9	YES	**Availability of forfeiture provisions** The consultation paper contemplates that, where the asset is shares and the participant is a public company, the expanded scheme would operate according to the company's forfeiture provisions in its articles of association. We would note that, although the articles of association of most companies will contain provisions relating to the forfeiture of shares, those provisions normally apply only to non-payment of calls made on partly-paid shares, which, given that shares must normally be fully paid to be listed, will most likely not be available to companies whose shares are admitted to trading on a securities exchange.

As a result, many companies will not be able use existing forfeiture provisions to seize shares that are "dormant" within the definition proposed in the consultation paper and some may not be able to adopt alternative provisions to that effect. Some companies also have provisions in their articles that give the company a power to sell shares where the shareholder cannot be traced, which is generally evidenced by a shareholder not claiming successive dividends over an extended period. These provisions are sometimes colloquially referred to as "forfeiture" provisions, although technically they do not involve forfeiture of the shares. Where these provisions exist, they generally allow the company to sell the shares of an untraced shareholder following publication of an advertisement, with the proceeds of sale being treated as a debt payable to the untraced shareholder (without interest). Legislation should make clear whether, in the event that the proceeds of sale are transferred into an ARF, the liability of the company to the untraced shareholder would be extinguished.

We are unsure whether the consultation intends to refer to the technical forfeiture provisions or to provisions giving a power of sale in relation to untraced shareholders, although we note that the ability of a company to capitalise the sum represented by the shares would generally only exist in relation to technical forfeiture provisions. We assume that the consultation paper contemplates that a company will use any power of sale provisions in its articles (thus allowing it to contribute any cash proceeds from the sale to an ARF), rather than any technical forfeiture provisions (which do not result in a cash sum being realised and almost certainly could only operate in their current form to transfer listed securities in the company to an ARF, which seems an unlikely intended outcome given the purpose of the dormant assets scheme and the function of an ARF). However, we would recommend that the Government clarify this in due course.

More generally, it is also possible that, for listed companies, the precise formulation a company is permitted to include in its articles, whether for technical forfeiture or for a power of sale, could vary according to the rules of the exchange on and jurisdiction in which its shares are admitted to trading, as the requirements of a relevant market may prevent issuers from adopting "standard" provisions in respect of forfeiture/power of sale.

We would welcome more clarity on how the Government's proposals are intended to operate given these constraints.

In particular, we understand that where the untraced shareholder provisions are present in a company's constitution, they are not commonly used by listed companies. It would be helpful to understand whether the FCA has a view on the circumstances in which it is appropriate for companies to exercise this power of sale and whether this would impact on the practicality of using this proposal under the expanded scheme for companies.

Intermediated securities

We also note that a company's articles are a contract between, and create rights and duties only as between, the company and its registered members. Where shares are held in an intermediated structure (see our comments above), the company will not be able to use its forfeiture provisions (or power of sale in respect of untraced shareholders) directly against the beneficial owner.

As a result, where the beneficial owner of a share has "gone away" but the shareholder of record (the nominee/custodian) has not, those provisions will not be available. See our comments above on who the relevant participant would be in these circumstances.

Other comments

- The scheme provides for compensation to asset owners who reclaim lost value from an ARF. The consultation paper notes that, when exercising their forfeiture provisions, companies might choose to absorb value into their share capital, rather than transfer to an ARF. In those circumstances, we assume that the asset owner would (and should) have no claim against an ARF, but the prospective legislation should address this.

- It is not clear to us from the consultation paper whether a company would need formally to forfeit shares in order to transfer unclaimed dividends to an ARF. The legislation should clarify this.

- The consultation paper states that the reclaim value for dormant share proceeds would be reckoned "in line with participating companies' share forfeiture terms". Provisions contained in articles of association relating to untraced shareholders will not generally be aligned with the definition of "dormancy", and we do not anticipate that many articles will contain a formulation for calculating a reclaim value. Again, we would welcome more clarity from the Government on this point, including whether it is proposed that companies include specific reclaim value formulae in their constitutional documents.

10. **Do you agree that legislation should make reference to participants making proportionate and reasonable efforts, based on best practice within their relevant sector, to reunite the asset with its owner before it can be transferred into the scheme?**

    Please consider whether there are any other ways that suitable tracing, verification and reunification practices could be encouraged and enabled in participants.

Question	Response (delete as applicable)	Comments
10	YES	We are concerned that, whilst there may be a "best practice" for banks and building societies to establish contact with "gone-away" customers, there is no such best practice for publicly traded companies vis a vis shareholders. Given the broad range of types of companies traded on securities exchanges, it is, in our view, unlikely that any best practice could ever be achieved or identified. We are also not convinced that best practices exist within particular sectors, as there will of course be companies of differing size, complexity and business model within the same sector. We would therefore recommend avoiding a reference to "best practice" for public company participants in any expanded scheme. Instead, we would recommend one or a combination of two approaches: • Companies could specify what steps they will take in their articles of association. This would provide clarity to shareholders. Additionally, because a shareholder resolution would be required to amend the company's articles to include these steps, they would have the benefit of approval

		by the company's membership, and any subsequent purchaser of shares would be "on notice". • Statute could set out the standard for steps to be taken. We would advise against including prescriptive steps in legislation, as this may encourage a "one size fits all" approach, whereas the steps that should be taken will no doubt vary depending on the size, complexity, business model and sector of the company in question. Instead, we would recommend including broad wording that can be interpreted sensibly by individual companies and, if ultimately necessary, the courts depending on the context. If the latter approach is adopted, we recommend aligning the wording with that of existing legislation. Potentially suitable wording includes that in section 982(5) of the CA 2006 (part of the statutory "squeeze-out" regime), which requires companies to make "reasonable enquiries" at "reasonable intervals". This is a standard with which registrars, who would no doubt carry out tracing under the expanded scheme on behalf of a company, are already familiar.

11. **Do you foresee any barriers to participation in the scheme or have any comments on its operation?**

    Please consider the feasibility of including eligible assets that are held within Stocks & Shares ISAs.

Question	Response (delete as applicable)	Comments
11	YES	We make no comment on assets held within stocks and shares ISAs. More generally, we see the following (each of which we have addressed in more detail elsewhere in this response paper) as barriers to participation in the scheme: • Lack of clarity as to how the scheme would operate where securities are held in an intermediated structure. • Lack of clarity around the steps a company would need to take to appropriate funds and transfer them to an ARF. • Potential issues relating to directors' duties (see below).

12. **Do you agree that the existing practice in the event of a participant's insolvency**

should be extended to all assets in an expanded scheme?

Question	Response (delete as applicable)	Comments
12	NO	We make no comment on this question.

13. **How could legislation on trustee, director or agent duties be amended to enable the proposed participants, as set out in Table 3, to take part in an expanded scheme?**

Question	Response (leave blank if no response)
13	Please see the comments below in our response to question 14.

14. **What protections might a trustee, director or agent need in such circumstances?**

Question	Response (leave blank if no response)
14	Directors are under a duty to promote the success of a company for the benefit of its members as a whole (section 172 of the CA 2006). For most publicly traded companies, this effectively equates to seeking to maximise profit in order to create value for shareholders. In this context, when faced with the choice between capitalising a sum for the benefit of the company or transferring it to an ARF (for onward distribution to charity), it is difficult to see how directors can conclude that transferring to the ARF would promote the success of the company. This may discourage directors from utilising the expanded scheme. To address this, directors of publicly traded companies that participate in the scheme would need comfort that they will be at lower, or no, risk of personal liability where they transfer funds to an ARF. One way to achieve this would be to amend the CA 2006 to permit directors to make transfers to an ARF without breaching their duties – a form of "statutory shield". This could be achieved by creating a statutory exception to directors' duties (so that a transfer does not constitute a breach of duty) or by creating a statutory bar to actions against directors for donations to an ARF (so that the transfer may constitute a breach of duty in certain circumstances,

	but no action can be taken). An alternative approach might be to create a statutory presumption of relief for breach of directors' duty by the court under section 1157 of the CA 2006. This would have the advantage of still permitting aggrieved shareholders to attempt a derivative claim against the directors of a company if they considered a transfer to amount to a breach of duty. However, it would also provide directors with additional protection by requiring the shareholders not only to prove that there is a breach of duty, but also that it is one for which the court should not grant relief. Whichever of these routes is chosen, appropriate protections would need to be included to ensure that the power to transfer to the ARF is not abused or used without due consideration. Conversely, any protections would need to be robust enough to prevent directors from being discouraged completely from ever making transfers to an ARF.

15. **What do you think the set up and ongoing costs of the expansion would be for participants?**

Question	Response (leave blank if no response)
15	

16. **What do you think the initial and ongoing benefits of the expansion would be?**

    In particular, we welcome estimates from potential participants on the value, number and age of dormant assets that they currently hold and could transfer into an expanded scheme, as well as how these figures are expected to evolve over time.

Question	Response (leave blank if no response)
16	

17. **Are there any other significant impacts of the expansion that the government should consider?**

Question	Response (delete as applicable)	Comments
17	YES/NO	