

U.K. SECURITY MARKETS

THE NEW TRANSFER SYSTEM AND THE REINTRODUCTION OF BEARER SECURITIES

Two important measures affecting the U.K. security markets were introduced a little over a year ago. Though not directly connected with each other, both were designed to facilitate business and increase the efficiency and attractiveness of London as an international financial centre. The notes which follow sketch something of the background to these measures, and take a look at their working so far.

1. The new transfer system

The background By the late 1950's it had become clear that the long-established common form of transfer which had to be signed by all parties before witnesses was cumbersome and out-dated, particularly in stock exchange transactions. Matters came to a head in 1959 when, in a period of exceptional stock exchange activity, long delays occurred in the registration of transfers and in the delivery of new certificates. In November 1959 the Chairman of The Stock Exchange invited representatives of the city institutions concerned with the transfer of securities to form a committee to find a simpler means of transfer.^(a)

A year later the Committee published a report recommending a new system under which it was proposed to :

- (i) introduce two new forms, the stock transfer form and the brokers transfer form;
- (ii) remove the need for the transferee (the buyer) to sign the transfer; and
- (iii) abolish the witnessing of signatures on transfers.

The stock transfer form, which would be signed only by the transferor (the seller), was designed to replace the common form in all types of transaction involving fully-paid registered securities. The brokers transfer form was for

use in conjunction with the stock transfer form in stock exchange transactions only. By the introduction of the new forms, the seller of a holding of securities on a stock exchange would no longer have to wait until the number of individual buyers of the holding were known and then sign a separate transfer to each. Instead he would be able to sign a single stock transfer form without delay; if there was only one buyer his broker would pass that form to the broker acting for the buyer, but if there were two or more buyers his broker would prepare separate brokers transfer forms for delivery to each buying broker.

Legislation and the Committee's guide The Committee's proposals were generally welcomed but they could not be implemented at once as they required a change in the law. The opportunity to bring in the necessary legislation came in 1963 when a Private Member's Bill giving effect to the Committee's recommendations was introduced in the House of Lords by Lord Clitheroe and later in the House of Commons by Mr. R. Graham Page. The Bill had the support of H.M. Government and became law in July 1963 under the title of the Stock Transfer Act 1963. As the new system was so different from the old, it was necessary to give as much guidance as possible to those who would have to operate it and the Committee published a comprehensive guide to the new system for the benefit of registrars and professional agents, such as banks, stock-brokers, solicitors and accountants.^(b) By the time the new system came into force in October 1963, 33,000 copies of the guide had been distributed and the change was made remarkably smoothly.

The Committee had drawn attention in their guide to some long-standing practices, not directly affecting the technique of the instrument of transfer itself, which might not be

^(a) Those invited were the Accepting Houses Committee, the Bank of England, the Chartered Institute of Secretaries, the Committee of London Clearing Bankers, the Council of The Stock Exchange and the Issuing Houses Association; the committee became known as the City Committee on the Transfer of Securities.

^(b) Copies of the guide are obtainable from the Secretary of The Stock Exchange, London, E.C.2, price 2s. 6d. post free.

compatible with the aims of the new system. As an example, they cited the method of settlement between broker and client, drawing particular attention to the practice of payment against delivery of the transfer which operated between many institutional investors and their brokers. Although institutional investors generally still require to see the transfer before paying for securities which they are buying, they are now prepared when selling to hand the signed transfer to their broker in advance of payment, against the broker's undertaking to pay them the purchase price on settlement day. This enables the broker, if there are two or more buyers, to proceed with preparing the necessary brokers transfer forms and thus to take full advantage of the opportunity for speedy delivery within the market which the new system has created.

To avoid invalidating the many transfers on the old form which had been signed but had not been registered when the Act came into force, it was necessary for the Act to preserve the old form. But it was important for the success of the new system that the maximum possible number of transfers should be made on the new forms. In their guide the Committee appealed to everyone always to use the new forms in preference to the old when dealing with securities transferable under the new system. Stock exchange regulations were altered to require members to use the new forms; other categories of professional agents also responded readily to the appeal and current records show that 99% of transfers received at the Bank of England for registration are on the new forms.

The new system in action That the new transfer system has succeeded in reducing work and delay is beyond doubt; the transfer no longer has to be sent to the transferee for signature and the transferor is relieved of the need to have his signature witnessed. Delivery of transfers within the Stock Exchange is quicker. The Stock Exchange

report^(a) that over 70% of transfers received by them for certification^(b) during the period of each 'account' are now dealt with not later than account day and that 45% of deliveries of transfers through their centralised delivery department are made on or before account day; the corresponding figures under the old system were about 12% and 15%, respectively. The Bank of England also have evidence of the speed with which transfers of government stock are made under the new system; of the stock bought from London jobbers, over 80% of the transfers are lodged here for registration within a week of certification by the Bank. This percentage would be even higher were it not for the few firms of brokers who are habitually slow in lodging their transfers.

The most persistent problem which registrars have met under the new system has been that of correcting an entry in the register when the details of the transferee's name and address are given wrongly in the transfer. Such mistakes have always occurred. Even under the old system a proportion escaped the notice of the transferee when the transfer was sent to him for signature; but in the past the registrar was able to look to the transferee, who had signed the transfer, for amending instructions. Now that the transferee has ceased to sign, some understandable confusion has arisen among registrars as to what evidence they should require before altering the register. The procedure suggested in the guide has been questioned and much conflicting advice given. To clarify the situation, the Committee have now set out in greater detail their recommended procedure. Having regard to the different views amongst registrars, the Committee, prior to publishing these further recommendations, submitted them to two leading counsel who have approved them.^(c) The real answer to this problem is to keep such mistakes to a minimum and The Stock Exchange have recently pointed out to their members the advantages to registrars and brokers alike if a little extra care is taken in inserting the details in the transfers.^(a)

(a) In an article by Mr. W. S. Wareham, the Secretary of the Share and Loan Department of The Stock Exchange, in the September 1964 issue of *The Stock Exchange Journal*.

(b) "Certification" is the marking of a transfer to the effect that a certificate covering the amount of stock being transferred has been surrendered to the registrar.

(c) Copies of the recommendations are obtainable from the Secretary of The Stock Exchange, London, E.C.2, free of charge.

Overseas securities

Not all the securities dealt in on stock exchanges here come within the scope of the new system as the legislation could not embrace securities of other governments or of companies registered outside Great Britain, not even when they were sterling loans entered in a register in this country. The Governments of Northern Ireland and the Republic of Ireland were quick to appreciate the benefits which the new system offered and have passed similar legislation. Most of the Commonwealth government stocks registered in London have been brought within the new system, as have the securities of a few overseas companies, but much remains to be done as there are still nearly 400 overseas securities in *The Stock Exchange Official List* which are not yet transferable under the new system.

2. The issue of bearer securities in the United Kingdom

The background

Before the war bearer securities were freely issued and traded in London, as in other financial centres. A feature of many securities issued in London was that investors had the option of holding them in either bearer or registered form, with facilities for changing from one to the other; this option was less common in centres overseas, where normally securities with a right to bearer were available only in that form. The bearer option was offered in the prospectuses of most British government loans issued up to 1940 and, although the nominal amount permanently held in bearer form was relatively small, for some loans considerable use was made of the facility for switching between bearer and registered stock.

Freely transferable bearer securities are, of course, a highly convenient means of exporting capital. The war made it necessary to restrict the transfer of capital overseas and, because bearer securities were obvious instruments for the evasion of this control, both their export and their issue without Treasury permission were prohibited in 1940 under the Defence (Finance) Regulations, 1939. This prohibition was carried forward under the Exchange Control Act, 1947, which provided also that (again

except with the permission of H.M. Treasury) bearer securities and coupons held in, or by residents of, the United Kingdom must be deposited with or, where applicable, held abroad to the order of an "authorised depository" (in practice, most such depositories nowadays are banks, stockbrokers or solicitors). Up to 1963, new issues of bearer securities were not permitted: such Treasury consents as were given were in general confined to the replacement of existing bearer securities, the conversion of existing registered securities into bearer securities in a few instances where special circumstances made this desirable, and the renewal of coupons for existing bearer issues where permission was specifically sought. No general permission for re-coupons was given, however, and up to the reintroduction of bearer facilities in 1963 coupons were not renewed for British government issues. During the period of prohibition consent was given, of course, to the issue of temporary bearer documents such as letters of allotment.

Towards the end of the 1950's the exchange control authorities had begun to feel that, with the easing of restrictions on dealings in securities and on transfers of non-resident held sterling, their ban on the issue of bearer securities could no longer be fully justified. It was thought that many people overseas, and particularly on the Continent, had retained since pre-war days a preference for bearer securities because they could be quickly and easily transferred without attracting stamp duty or other charges; the issue of further sterling securities in this form would therefore, it was argued, tend to make long-term overseas investment in the United Kingdom more attractive, with some benefit to the United Kingdom's balance of payments and to the standing of London as a financial centre. Also it was thought that, although the demand for British government stocks in bearer form might be comparatively small (British government stocks were already exempt from stamp duty), where there was originally a right to hold a British government issue in bearer form this right should be restored as soon as practicable.

Preliminary investigations were being made by the Bank of England and the Treasury in 1958 and in November of that year the Chancellor of the Exchequer, in answer to a question in the House of Commons, stated that:

"... it would be reasonable to allow a company to convert its registered shares into bearer form if it could show good reason for this, if the bearer share warrants would be of small denomination and provided that the arrangements would be such as to ensure that capital could not be exported from this country without Treasury consent".

It was implied that, while not yet actively encouraging the issue of bearer securities or the conversion of existing registered securities into bearer form, the Government were prepared to consider easing the ban.

The problem of stamp duty The practical problems of reintroducing bearer, in general and specifically for government securities (of which the Bank are Registrar), then began to be studied by the Treasury, the Inland Revenue and the Bank of England in considerable detail. It soon became obvious that a change in the law relating to stamp duty would be essential before general permission for a return to bearer could be given. On transfer of most registered securities in the United Kingdom, other than British government stocks, a stamp duty of 2% *ad valorem* (*i.e.*, on the cash value of the transaction) was payable; and, although, as already mentioned, no duty was payable on the transfer of bearer securities, when they were issued in the United Kingdom for the first time they normally attracted a once-for-all duty of 6% on the nominal value. As the market value of many quoted shares was by this time well over four times their nominal value, there would have been an obvious incentive, if bearer issues were again generally permitted, for sellers of registered securities with a market value more than three times the nominal value to convert them into bearer and to recover the stamp duty on the issue of the bearer bonds from the buyers, sharing with them the net saving in duty. The losers would be the Inland Revenue.

A possible way round this difficulty would have been to increase the duty on issues of bearer from 6% nominal to 6% *ad valorem*. Such a move would, however, have been extremely unpopular. Many voices were then urging the need for a reduction, or even for the abolition, of stamp duty on transfers in the interests of wider share ownership. Additionally, the City Committee referred to in the first part of this article was at the time

investigating the whole question of share transfer procedure with a view to its simplification. Implementation of its findings, it was thought, could possibly have involved some changes in stamp duty. A temporary change in the interim seemed undesirable; further progress towards the restoration of bearer issues was not therefore possible until the stamp duty problem could be settled.

In the event, it was 1962 before the matter could be considered again: the Inland Revenue had by then completed a general review of stamp duties; and, with the prospect of the United Kingdom entering the Common Market, it was thought important that London should be in a position to offer the fullest facilities to continental investors. The Government now found it possible to give active support for the reintroduction of bearer, and, when a decision had to be made whether to issue fresh coupons for the outstanding bearer bonds of 3½% War Loan, the coupons of which would be exhausted with the payment of the interest due the 1st December 1962, it was felt that re-couponing need no longer be rejected on principle. Notice was therefore given in November 1962 that holders of existing bonds would, from the 4th March 1963, be entitled to new bonds with coupons starting with the payment due the 1st June 1963.

The Finance Bill, 1963 The decisions reached as a result of the long study of the stamp duty and bearer security problems were embodied in the Finance Bill, 1963. In his budget speech the Chancellor made it clear that he intended to remove the exchange control ban on the issue of bearer securities. The relevant provisions of the Bill were:

- (i) transfer stamp duty was reduced from 2% *ad valorem* to 1% *ad valorem*;
- (ii) U.K. bearer securities (other than those issued by the British Government) were to attract, on issue, a duty of three times the transfer stamp duty (*i.e.*, the duty would be 3% *ad valorem* instead of 6% nominal);
- (iii) the right to exchange government stock into bearer, where this right originally existed, was to be restored on the direction of the Treasury;

- (iv) the Treasury were to have the power, by statutory instrument to be laid before Parliament, to permit bearer facilities for those British government securities which did not carry such facilities in their original terms of issue; and
- (v) holders of certain British government securities were to be given the right to a bearer bond in place of a stock certificate to bearer—a document similar to a bond but with certain technical differences—where the latter document had been available before the war.

With the passage of the Bill, the stamp duty provisions became law on the 1st August 1963 and at the same time, as mentioned in the Bank's *Annual Report* issued in July 1964, a general permission under the Exchange Control Act, 1947, was given by the Treasury for any *new* issue, which otherwise conformed with exchange control requirements, to be in the form of bearer securities; it was announced also that consideration would be given to specific applications to issue bearer securities in exchange for registered securities which existed before that date. Since this permission was given, new issues of bearer, apart from those made by the British Government, have been largely confined to those loans denominated in U.S. dollars raised by certain overseas borrowers and intended mainly for overseas investors: and in the case of these loans the actual delivery of the bearer securities has taken place abroad and has thus been free of U.K. stamp duty. Few applications have been made by borrowers in the United Kingdom for permission to make bearer facilities available for registered securities which were in existence before the 1st August 1963.

British government securities The Bank of England were not affected, as Registrar of British government securities, by the stamp duty changes which were to become law on the 1st August 1963. Accordingly the Treasury gave the Bank permission in May 1963 to embark upon a programme for the reintroduction of bearer facilities. Priority was given in the programme to those stocks originally carrying a right to bearer and to those on which interest could be paid tax free to non-residents, the latter having a greater

appeal to overseas investors. Since the spring of 1963 the bearer option has been offered for all new British government issues. Up to the present, bearer bonds have been made available for the following securities:

- 3½% War Loan
- 4% Funding Loan 1960/90
- 4% Consolidated Loan
- 5% Exchequer Loan 1976/78
- 5½% Treasury Stock 2008/12
- 3½% Conversion Loan 1961 or after
- 4% Exchequer Loan 1968
- 5½% Funding Stock 1982/84
- 2¾% Guaranteed Stock
- 3% Guaranteed Stock
- 3% Redemption Stock 1986/96
- 5¼% Funding Loan 1978/80
- 2½% Annuities
- 2¾% Annuities
- 5¾% Funding Loan 1987/91
- 2½% Consolidated Stock
- 3% Funding Loan 1959/69

In addition to the issues listed, new coupon sheets have been made available this year for 4½% Guaranteed Bonds so that registered holders of these bonds may, if they wish, convert their holdings into bearer form.

Over the years, the term 'loan' has, in general, been used in the title of British government issues where bearer facilities were offered in the prospectus; where these were not offered the word 'stock' was considered more appropriate. For the sake of consistency, it has been decided that, where possible, the word 'loan' should be used on bearer bonds now being issued, including those relating to stocks for which bearer facilities were not previously available.

In implementing the programme the Bank have taken the opportunity of simplifying the design of the bonds to give them a more modern appearance, and have also introduced a larger coupon of a type which could be printed with magnetic characters suitable for electronic sorting and accounting. The bonds measure about six inches by nine inches and the coupons about six inches by three inches. These measurements are within the maximum

recommended jointly by The Stock Exchange and the Chartered Institute of Secretaries, and the coupons accord with the minimum standards adopted both in the United Kingdom and the United States for processing by electronic machines. Reference was made to this new style of bond, which was introduced for 3½% War Loan, in the Bank's *Annual Report* issued in June 1963.

Between June 1963 and the end of November 1964, some 9,000 British government bearer bonds with a nominal value of £6.9 million have been issued; of these bonds about half were subsequently converted into registered stock. Thus the demand for the facility has

so far been comparatively small. It is possible that demand in the London money market for bearer might have been larger had the facility not existed whereby dealers in the gilt-edged market are permitted to obtain from the Bank certificates of their holdings at the close of business each day; these can be used as security for overnight advances. This apart, the experience of the last eighteen months has probably vindicated the view held in 1958 that, although demand was likely to be small, it was right to reintroduce bearer facilities for British government issues as soon as practicable, and thus to expand the facilities offered by the London market.