Are share certificates facing extinction?

Although we live in a material world the days of dealing in share certificates on the London stockmarket are numbered. On the opening bell at 8am on the 6th October this year European stockmarkets including London ushered in a new dawn. The standard settlement time was reduced to only T+2 where buy and sell bargains now settle 2 business days after the trade being struck in the market.

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Technology has revolutionised share trading. The inception of electronic settlement for share deals has reduced settlement times making traditional share certificates a slow and inefficient manner to settle trades. Without a doubt private investors still cherish a paper share certificate but the tide is turning definitely towards electronic share dealing.

To sell shares held in certificated form you have to sign a stock transfer and send it together with the covering share certificate to your broker, who will check these items are for good delivery and send them to the registrar, only then can settlement take place through the electronic Crest system. In the days when the standard settlement time was T+10, this postal trading process was relatively unproblematic - in settlement terms at least. However, electronic settlement has reduced the standard settlement time to T+2.

Postal dealing of certificates is impossible in this timescale and investors who insist on dealing in certificates are beginning to find that they are presented with higher buying and lower selling prices. Market makers (the final counterparties) in share deals) hold stock like warehouses so the longer it takes for them to receive either payment for shares they have sold or shares they have bought to sell on, the less money they can make. Also, the need to wait for a share certificate means that the risk of fraud is much higher and similarly market makers are beginning to protect themselves by widening bid-to-offer spreads for certificated deals.

Furthermore, physical share certificates carry the additional risks such as forgery, loss, damage and theft and their related costs for rectification. For example, if a share certificate is "lost" the registrar upon being notified will place a "stop" on the certificate in existence so it can no longer be used if it falls into the wrong hands and at the same time will issue a letter of indemnity to be signed by the registered holder before releasing a duplicate.

This whole process causes delays, and requires the correct administrative procedure being followed, resulting in a timely and costly exercise. In some circumstances where the stock covers a considerable monetary amount, it may not be possible to find a willing party to countersign the indemnity. This is another reason why shareholders should give serious consideration towards choosing to hold their stock electronically. In November's annual regional meeting of the Wealth Management Association (formerly APCIMS) their Head of Compliance Ian Cornwell reported that dealing in share certificates will be phased out by 2017 as the London sharemarket "catches up" with bond markets and other electronic stockmarkets around the world.

The upside is that electronic administration speeds up the settlement process and so putting investors "in the money" much more quickly and requires less physical administration and therefore reduces dealing costs for investors. Brokers can offer dealing in stocks from anywhere around the world and clients with electronic holdings are reassured that trades will settle quickly and efficiently into their account.

Electronic holdings are normally held in a broker's nominee who will carry out the normal administration such as stock splits, takeovers, mergers and scrip dividends. The downside is that private shareholders no longer appear on the share register because the nominee is the legal owner and individual investors are merely beneficial owners. However, investors can choose to receive voting rights, company reports and shareholder perks through their bespoke broker's nominee if they wish to.

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