

Feature

KEY POINTS

- After more than 10 years in operation, the scope of the Dormant Bank and Building Society Accounts Act 2008 is being expanded to include certain types of non-cash financial assets. Intermediated securities have not been included among the proposed additional eligible asset classes.
- A major advantage of the legislation is that liability for assets that are transferred under the legislation passes from the participant to a reclaim fund. This contrasts with the regime for disposal of allocated but unclaimed assets under the Financial Conduct Authority's client asset protection rules, which leaves firms disposing of unclaimed client assets with perpetual reclaim liability.
- Noting that the intermediated system is the predominant structure for UK public securities, the authors argue that bringing intermediated securities within scope of the legislation would reflect the operational reality of UK public securities holdings and is likely to significantly increase its social impact.

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Why intermediated securities should be brought within scope of the expanded Dormant Assets legislation

In this article the authors set out an overview of the proposed expansion of the Dormant Bank and Building Society Accounts Act 2008 and a critical examination of the possible reasons for leaving intermediated securities out. They argue that bringing intermediated securities within scope of the legislation would reflect the operational reality of how UK public securities are held, maximise the legislation's impact, and could generally be done without too much conceptual difficulty.

INTRODUCTION

For a number of years the existence of unclaimed assets in the financial services sector has attracted attention. The UK Dormant Assets Scheme (Scheme) was established by the Dormant Bank and Building Society Accounts Act 2008 (Act) as a pragmatic solution to the issue. The Act provides a mechanism by which money left in participating bank and building society accounts that has been dormant for more than 15 years can be managed and distributed for defined social and environmental purposes, where reunification with the owners is not possible. This responds to a public interest and sustainability imperative for financial assets that have no obvious owner to be put to good use rather than languish, forgotten, in bank accounts.

After more than 10 years in operation, the scope of the Act is proposed to be expanded to include certain types of non-cash financial assets. Securities in book-entry format which are held by investors through a chain of intermediaries (intermediated securities) are not included in the proposal. We argue

that the currently envisaged expansion of the Scheme will not affect the vast majority of non-cash financial assets, and that at least from a legal perspective intermediated securities – at least intermediated UK securities, in certain circumstances – could be accommodated within the Scheme without particular difficulty.

OVERVIEW OF THE SCHEME

Participation in the Scheme is voluntary. The Scheme is administered by Reclaim Fund Ltd (RFL)¹ which is responsible for managing money transferred into the scheme, meeting any reclaims and passing on surplus money for reinvestment in the community through the National Lottery Community Fund (NLCF). As at the start of 2021, the Scheme had received £1.35bn in dormant money and had released £745m to the NLCF.² Distribution from the Scheme has supported youth projects, community finance, climate change and sustainability initiatives, among other projects.³

Money transferred to the Scheme can be reclaimed at any time by the person

entitled to the relevant account. However, the transfer of an asset to RFL extinguishes the right of the owner against the relevant institution and replaces this with a claim against RFL. Hence, RFL is legally obliged to retain a portion of the funds it receives in order to repay owners who come forward to reclaim their money. Around 7.5% of monies transferred to RFL have been reclaimed by owners.⁴

Utilisation of the Scheme has been accompanied by efforts in the bank and building society sector to reunite dormant account customers with their money. In January 2008, an online tracing service for customers trying to locate their lost accounts – mylostaccount.org.uk – was launched on a cross-industry basis. Mylostaccount.org.uk continues to be free to use for anyone looking to trace lost personal accounts even if they are unsure of which bank or building society holds the account and including instances where the bank or building society has since closed or merged.

EXPANDING THE SCHEME: THE DORMANT ASSETS BILL

A review of the Act by the government, in 2014, concluded that the Scheme was “working well” and had been a success.⁵ In 2016, the government convened an independent commission (Commission) to consider the most effective way of broadening the range of assets that could be included in

the Scheme. The Commission's 2017 report⁶ made several recommendations regarding the expansion of the Scheme to include additional asset classes from the financial services sector while retaining core principles of the Act (reunification first, full restitution and voluntary participation).

Building on the Commission's work and subsequent industry engagement, which included a report by "industry champions" to ensure that changes were led by the financial services industry,⁷ the Dormant Assets Bill (Bill) was published and had its first reading in the House of Lords on 12 May 2021.

Among other things, the latest version of the Bill⁸ makes amendments to the Act to expand the existing Scheme to allow certain dormant assets from the insurance and pensions, investment, wealth management, and securities sectors, to be transferred into the scheme. However, only cash may be transferred into the Scheme; non-cash assets must first crystallise or be converted to cash in order to be eligible for transfer. The new classes of eligible assets are:

- long-term insurance assets, namely rights against insurance institutions to payment of any eligible insurance proceeds (cls 2 to 4 of the Bill);
- pension assets, namely rights against pension institutions to payment of (or to elect how to receive) any eligible pension benefits (cls 5 to 7 of the Bill);
- investment assets, namely rights against investment institutions to payment of any eligible amounts owing by virtue of authorised collective scheme investments⁹ (cls 8 to 11 of the Bill);
- client money assets, namely rights against investment institutions¹⁰ to payment of any eligible client money (cls 12 and 13 of the Bill). "Client money" means money held in trust for a person or treated by the investment institution holding it as client money; and
- securities assets, namely rights to payment of any eligible proceeds or distribution relating to shares in traded public companies (cls 14 to 16 of the Bill). A "traded public company" is a public company (within the meaning of s 4(2) of the Companies Act 2006)

whose shares are traded on a UK regulated market or a UK multilateral trading facility.

For each type of asset, the Bill sets out a definition of dormancy that is tailored to the asset class. It sets how the general principles of the Scheme apply to that asset type, certain operational details, and the types of institution that may participate in the expanded Scheme. The Bill also makes it a requirement for participants in the Scheme to make attempts to reunite assets with their owners.

The government estimated that there may be an additional £3.7bn of dormant assets in total in the new asset classes proposed in the Bill. Of this sum, it anticipated that £2bn might be returned to their owners (as a result of enhanced tracing efforts), with the remaining £1.7bn transferred to the Scheme. Therefore, based on RFL's current reserving policies, the expansion of the Scheme under the Bill is set to make £880m available across the UK, as it recovers from COVID-19.¹¹

FUTURE EXPANSION: THE CASE FOR INCLUDING INTERMEDIATED SECURITIES ASSETS

Intermediated securities are not generally covered by the Bill.¹² Clause 14 of the Bill, which envisages the transfer of "securities assets" to the Scheme, only applies in respect of a traded public company transferring dormant eligible proceeds or distributions relating to a share in the company that is registered in the name of an individual. Intermediated shares, on the other hand, will be registered in the name of a nominee or custodian which holds the shares, on trust, for the "real shareholder" (and in some cases, there may be both a custodian and a nominee). The real shareholder's entitlement will be a beneficial claim against the custodian or nominee, arising under a trust or sub-trust (with the custodian or nominee being a trustee or sub-trustee, as applicable).¹³

Hence, the Bill does not currently propose a means for custodians or nominees holding dormant intermediated securities accounts, whether in respect of UK or international

securities, to transfer the securities entitlements recorded in those accounts to the Scheme. Among other reasons, dormant assets in this sector could arise because of fractional entitlements or assets not being picked up by probate. What's more, since intermediated securities holders are generally more likely to be engaged, assets classed as dormant will genuinely have little prospect of being reunited with their owners.

In reality, the main reason why intermediated securities were left out may very well be that the intermediated holding system was not fully appreciated, but there could be certain other reasons. First, intermediated securities may have been regarded as too "complex", operationally, to transfer to the Scheme.¹⁴ Second, avoiding conflicts of laws seems to be another key design principle: in its consultation paper, the government insisted that the terms and conditions of any asset transferred to the Scheme should not be "governed by a legal jurisdiction outside the UK".¹⁵ Intermediated securities can involve intermediaries located in different jurisdictions (even with respect to UK securities). The government may have been concerned by potential cross-border issues. Third, the government may have considered that the client asset sourcebook (CASS) rules of the Financial Conduct Authority (FCA) already provide an effective means for dealing with dormant "safe custody assets" (which includes intermediated securities) held by custodians and other firms subject to CASS 6. Under CASS 6.2.7AR to CASS 6.2.16G, a firm may either liquidate an unclaimed safe custody asset it holds for a client, at market value, and pay away the proceeds, or pay away such safe custody asset, in either case, to a registered charity of its choice, provided that:

- this is permitted by law and consistent with the arrangements under which that safe custody asset is held;
- the firm has held that safe custody asset for at least 12 years and in the 12 years preceding the divestment of the asset, it has not received instructions relating to any safe custody assets from or on behalf of the client concerned;
- the firm can demonstrate that it has

Feature

taken reasonable steps to trace the client and return the safe custody asset; and

- the firm complies with an “undertaking requirement”.

The “undertaking requirement” is that the firm or a member of its group must unconditionally undertake to pay to the client concerned a sum equal to the value of the safe custody asset at the time it was liquidated or paid away in the event of the client seeking to claim the safe custody asset in future.

The Bill does propose to confer power on the Secretary of State or HM Treasury to make regulations further expanding the scope of the Scheme and introduces a new power for HM Treasury to establish other reclaim funds as appropriate (cls 19 and 26). This is consistent with Commission and industry recommendations for there to be subsequent phases of expansion. Notably, the industry champions report stated that transfers from “corporate sponsored nominees” may be included in a subsequent phase.¹⁶ An amendment to the Bill proposed by Lord Bassam and Baroness Bowles would require periodic reviews (within three years of the day on which this Bill is enacted, and every five years afterwards) of the Scheme, including the impact of the Scheme and its expansion and whether new assets should be added to it.¹⁷

At least from a legal perspective, there are really no conceptual difficulties standing in the way of bringing at least some intermediated securities in scope of the Act. After all, the Bill already accommodates at least one type of trust asset (client money).¹⁸

Addressing the possible rationales for excluding intermediated securities suggested above, in turn, the following shows why making intermediated securities eligible for transfer to the Scheme is likely to make a significant contribution to reducing dormant assets.

The easy fix to the suggested issue of operational complexity is the one employed by the Bill for the non-cash asset classes that are included: conversion to cash before transfer to the Scheme. Indeed, the FCA could perhaps allow, under CASS 6, liquidation of custody

assets into client money, which could then be paid into the Scheme.¹⁹

The intermediated securities system has led to the choice of law rule known as “PRIMA”, an acronym for the place of the relevant intermediary account. Under PRIMA, property rights in relation to client assets are determined broadly by the law of the jurisdiction where the relevant intermediary account is maintained. This means that for an intermediary holding a dormant intermediated securities account for its client on its books and records in its London branch, the English courts can be expected to regard English law as the law governing proprietary issues in relation to the account, regardless of the locations of other intermediaries and accounts in the chain.

The FCA’s CASS 6 process for disposing of unclaimed assets leaves firms with continuing reclaim liability, which is a key disadvantage relative to the Scheme.²⁰ Moreover, CASS 6 may not apply to a particular intermediary relationship. Payment into court under s 63 of the Trustee Act 1925 or an application under Pt 64 of the Civil Procedure Rules may be an option, in theory, but the practical usefulness of these procedures for dealing with intermediated securities is also doubtful. In practice, firms tend to hold the unclaimed assets in perpetuity (until depleted by costs).

This is an unfortunate state of affairs. Far from being obscure and specialist, the intermediated system is, and is likely to remain, the predominant structure for transacting and settling transactions in public securities in the UK. The intermediated system may be more complex, but it offers investment, operational and costs advantages. As Hildyard J observed in *SL Claimants v Tesco Plc*, “the intermediated securities market is of great practical importance and huge significance to the financial strength of UK plc”.²¹

Interestingly, the government’s answer to a written question on the expansion of the Scheme²² provided a breakdown, by type of asset, of estimated dormant assets under the expanded Scheme. This showed an estimate of £158m for securities (compared

to £2.1bn for insurance and pensions and £1.4bn for investment and wealth). The figure for securities would be significantly greater if intermediated securities were included. Intermediated securities are likely to be the biggest source of dormant securities, if not the biggest single source of dormant assets overall. In its current form, the Bill would overlook the reality of the UK securities market and would not affect the vast majority of dormant UK securities. ■

- 1 The Act envisages that there may be more than one reclaim fund.
- 2 Government Response to the Consultation on Expanding the Dormant Assets Scheme (available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/951269/Government_response_to_the_consultation_on_expanding_the_Dormant_Assets_Scheme.pdf), 9 January 2021, p. 2.
- 3 See speech to the House of Lords by Baroness Barran, Hansard volume 812 (available at: [https://hansard.parliament.uk/lords/2021-05-26/debates/47D12772-75FC-4FE5-858B-A76E7D829F1C/DormantAssetsBill\(HL\)](https://hansard.parliament.uk/lords/2021-05-26/debates/47D12772-75FC-4FE5-858B-A76E7D829F1C/DormantAssetsBill(HL))), 26 May 2021.
- 4 Department for Digital, Culture, Media and Sport and HM Treasury, “Dormant Assets Bill: factsheet one: bill overview” (available at: <https://www.gov.uk/government/publications/dormant-assets-bill-factsheets/factsheet-one-bill-overview#key-facts-and-figures>), 13 May 2021.
- 5 “Review of the Dormant Bank and Building Society Accounts Act 2008” (available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/298366/review_of_dormant_accounts_act_2008.pdf), 27 March 2014.
- 6 *Tackling Dormant Assets: Recommendations to Benefit Investors and Society* (available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/596228/Tackling_dormant_assets_-_recommendations_to_benefit_investors_and_society__1_.pdf), 3 March 2017.
- 7 *The Dormant Assets Scheme: A Blueprint for Expansion* (available at: <https://assets>).

Biog box

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publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/792528/Industry_Champions_Report_on_Dormant_Assets_2019_full_report__2_.pdf), 4 April 2019. This was followed by the government's "Consultation on Expanding the Dormant Assets Scheme" (available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/959098/Consultation_on_expanding_the_dormant_assets_scheme_V2.pdf), 21 February 2020 and response (cited in note 1).

- 8 As at the date of this publication, the Bill had progressed to Committee Stage in the House of Lords on 21 June 2021 and was awaiting a date for its Report Stage.
- 9 Authorised open-ended investment companies, authorised unit trusts and authorised contractual schemes.
- 10 Broadly, with respect to collective investments, "investment institutions" are fund managers or depositaries that are authorised under the Financial Services and Markets Act 2000 (FSMA) whereas with respect to client money, "investment institutions" refer more generally to firms which are authorised under FSMA.
- 11 See House of Lords, "Written Question: Dormant Assets Scheme" (available at: <https://questions-statements.parliament.uk/written-questions/detail/2021-04-12/179699>), 19 April 2021 and the Queen's Speech 2021: Background Briefing Notes (available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/986770/Queen_s_Speech_2021_-_Background_Briefing_Notes..pdf), 11 May 2021, p 119.
- 12 We have not considered whether investment assets may, in some circumstances, effectively constitute intermediated securities.
- 13 This has been confirmed by the English courts in a number of cases: see, for instance, *Re Lehman Brothers International (Europe) (In Administration)* [2009] EWHC 2545 (Ch) and *Re Lehman International (Europe) (In Administration)* [2010] EWHC 2914 (Ch), and recently, *SL Claimants v Tesco Plc* [2019] EWHC 2858 (Ch), in which Hildyard J described an investor's entitlement as a

"a right to a right".

- 14 See the industry champions' report (cited at note 6), which recommended that the inclusion of transfers from "corporate sponsored nominees" should be subject to a phased approach, in order to "allow RFL time to build and develop the capabilities for managing the market value risk of non-cash assets, and for companies to put in place the appropriate processes over time and increase their confidence in participating in the scheme" (p 68).
- 15 Page 10. Moreover, eligible participants must have a head office or establishment in the UK.
- 16 Page 33.
- 17 House of Lords: Dormant Assets Bill: HL Bill 37(a) Amendments for Report (available at: <https://bills.parliament.uk/publications/42885/documents/718>), dated 29 September 2021, published 1 October 2021.
- 18 It also provides that a transfer of an amount to RFL in accordance with the Bill does not, in and of itself, constitute a breach of trust or fiduciary duty affecting the amount owing, or give rise to any liability of any kind (other than the liability of RFL to honour a reclaim).
- 19 This may depend on the ability of a firm to hold client money for a period, if necessary, before transfer.
- 20 It is not known whether the FCA intends to amend the CASS rules to align with the operation of the Scheme.
- 21 At [73].
- 22 Cited at note 10.

Further Reading:

- Intermediated securities: the "no look through" principle will work alongside necessary changes (2020) 3 JIBFL 152.
- Intermediated securities in a securities class action context (2021) 4 JIBFL 260.
- LexisPSL: Financial Services: Practice Note: Dormant accounts.