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TAKING STOCK

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A case of ring-barked assets?

The collapse of Beaufort Securities has re-focused attention on the rights of nominee account holders

Midway through May, editor John Hughman provided a rundown on the collapse of UK stockbroker Beaufort Securities, or rather the controversy that had arisen surrounding the fee schedule for the administrator, PwC, along with the whole issue of 'ring-fenced' accounts.

In a nutshell, the Financial Conduct Authority (FCA) declared Beaufort Securities and its custodian arm insolvent on the morning of 2 March, just a few hours before the US Department of Justice charged the firm with fraud after a probe uncovered irregularities linked to money laundering and a stock manipulation scheme. At that point the stockbroker was holding around £50m in segregated client monies, in addition to securities held as part of its nominee arrangements, representing nearly £850m.

Management at Beaufort was suitably aghast at how quickly the FCA had moved on the issue, particularly as it claimed that UK regulators hadn't been in contact regarding any red flags in the lead-up to the declaration. But I suppose that the involvement of a federal executive branch of the US government might have concentrated minds. Anyway, allegations of fraud aside, given that the stockbroker's registry records were apparently all in order, you could be forgiven for thinking that an orderly return of investor funds would have been a relatively straightforward process.

Naturally, the rump of the stockbroking business would still require funding for retained staff, premises costs and IT support, but the initial stab by PwC at the likely level of administrator fees, some £100m, seemed, as our editor put it "an extraordinarily high figure in the context of the overall amount of funds to be returned". Indeed, the scale of the estimate also seemed totally out of whack given that Beaufort's combined cost-of-sale and admin expenses for 2016 amounted to just £12.9m.

It's surprising that PwC was able to pare down its original ball-park estimate to around £55m, although the accountancy giant now thinks the process will be finalised in around two years, instead of the initial four-year assumption, subject to review.

The likely scale (and timeframe) of the fee schedule is one thing, but the main reason why the Beaufort issue has become so contentious was the realisation that administrators can access client shares and/or assets in the event of the collapse of financial institutions with nominee or custodian accounts, under provisions set out in Rule 135 of the Special Administration Regime.

PwC has subsequently revealed that stakeholders in the liquidation, including the Financial Services Compensation Scheme (FSCS), have agreed a cost allocation that will see 94 per cent of the costs for returning assets to approximately 17,500 retail and corporate clients covered by the FSCS, with "fewer than 10 retail clients" facing "any costs exposure at all".

Whether this represents an equitable outcome probably depends if you're one of the 10 retail clients in question, but there are wider issues. One of those is that people are being encouraged to take more control of their retirement savings and in so doing accumulating ever larger investments pots – thus the IC editor's belief that "the UK's investor compensation scheme is simply no longer fit for purpose" will doubtless attract support. It certainly chimes with the parallel view of ShareSoc director Mark Bentley, who also thinks the FCA should absorb the costs of these types of administrations, as it is ultimately "responsible for verifying that asset managers are properly ring-fencing client assets".

ShareSoc representatives, along with *FT* columnist Lord John Lee, will be speaking to City Minister John Glen later this month over proposed reforms to the Special Administration Regulations. The team will also be highlighting the need for the Department for Business, Energy and Industrial Strategy to look again at the implementation of the EU Shareholder Rights Directive with the aim of ensuring that "the rights of beneficial owners of shares are properly enshrined in UK law and not granted to intermediaries, as they are at present".

Several IC columnists, most notably Alastair Blair, have repeatedly set out the case for an overhaul of the nominee account framework, not just in terms of the possible marginalisation of minority holders through the potential abuse of the pre-emption principle etc, but also regarding individual voting rights. So, we'll keep you up to speed on developments, as it's obviously troubling for anyone who has taken out Isas, Sipps or trading accounts that were marketed as ring-fenced.