Stop the presses

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Business, like fashion, is often subject to abrupt changes in style. Occasionally, however, a more fundamental change or a new technology works its way gradually through an industry until it eventually displaces the conventional approach entirely. One example of that is the way paper stock certificates are now 'fossils' in much of the world. Markets in countries across the globe consider paper certificates too expensive to store and process, too easy to forge and all too easy to steal. So they're getting rid of them and generating big savings in the process.

China, for example, no longer bothers with paper stock certificates. Bonds, equities and other securities in China are all issued and traded electronically. Stock forgery is no longer a problem there. Nor is the cost of printing, sorting, processing and keeping securities in custody. France was also one of the first countries in Europe to say no to paper securities; it began eliminating paper as early as 1984. Today, stocks, bonds and government securities in France are all issued and traded electronically.

That is not the case, however, in the US. Although most bonds and other securities issued in US markets are electronic or paperless – and therefore difficult to steal or destroy – many equities or common stock continue to be issued as paper certificates. The result is all too predictable: last year alone, some 1.4 million US securities were reported lost, stolen or forged. And according to a study by the Securities Industry Association, it cost investors, banks and brokerage firms more than USD 250 million last year just to handle, process and maintain custody of paper certificates.

Fragile paper

On 9/11, some USD 16 billion worth of paper certificates disappeared in the collapse of the World Trade Center towers. By using its electronic records, the securities industry eventually was able to reconstruct ownership of the securities. But the lesson was not lost. Paper proved far more perishable than computer files.

In many markets throughout the world, it has been the advent of new technology, combined with the need to prevent securities theft and hold down costs, that has helped spur the drive to phase out paper securities and replace them with electronic, book-entry registration. India, for example, which set about reforming its stock market mechanisms in the mid-1990s, was among the first

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markets to adopt internet trading and paperless securities. By 1997, investors seeking to purchase shares in an initial public offering in India could only do so electronically. In South Africa, the introduction of new technology on the exchanges in the late 1990s led to much higher trading volumes. The result was a deluge of paper certificates which clerks could not sort through fast enough. The solution? Go paperless.

European pioneers

The Danes can claim to be among the original European leaders in paperless securities. To overcome a clerical logjam, they began changing some securities to paperless registration as early as 1983. In 1987, the Danish government started to issue book-entry-only bonds and other securities. It also began educating investors on the advantages of electronic ownership. Today, no securities traded in Danish markets ever see a printing press.

In the US, federal government securities are also entirely paperless, and the US Treasury started issuing electronic securities the same year as Denmark's National Bank. Stung by the disappearance of USD 7.5 million of Treasury bearer securities in the early 1960s, and concerned about the high operating costs for handling paper certificates, the Federal Reserve gradually began to dematerialise its bonds and notes. In 1986, the Treasury issued its last paper security and the next year, right in step with Denmark, US government securities went paperless. Other Scandinavian markets, including Norway, Sweden, Finland and, by extension, Iceland, also do business only in book-entry securities. In Switzerland, if a shareholder wants a paper certificate, the share registry will print one out and deliver it. But more than 98% of securities in Switzerland are paperless.

Paper certificates are passé in key Latin American markets, as well. In Brazil, for example, although companies have the right to issue paper shares, only one does so. All other companies have gone electronic. Mexico puts all paper securities in its central depository, and once the paper is there, it doesn't leave. Instead, the depository keeps records by book entry and simply issues a statement of ownership to investors.

Changes in the east

In Asia, low-volume markets like Sri Lanka and high-volume, international markets like Singapore also operate without paper securities. Hong Kong's very active market is pursuing an ambitious plan toward paperless registration, and now the grandfather of Asian markets, Japan, has set a date for the retirement of all paper from its systems.

In Japan's markets, as in the US, most securities are paperless. The exception, just as in the US, is common stock; many Japanese companies still issue paper stock certificates. But the end of paper is now in sight. Meanwhile, the idea of doing away with paper securities on the London Stock Exchange (LSE) continues to spark interest. While some 85% of UK trades are already electronic, the LSE is one of the world's major markets, so the volumes involved are substantial. Behind the push for paperless securities is a rising concern about trading costs. The European Securities Forum estimates that settling transactions on the LSE is twice as expensive for paper shares as for electronic shares. Since the LSE accounts for about 40% of European share trades, the costs savings from jettisoning paper would be substantial.

Even US markets are now edging toward ending the practice of issuing common stock on paper. For nearly a decade, U.S. companies have had the opportunity to issue equity shares electronically, and more than 1,000 issues are now paperless. US companies also issue paperless, book-entry shares that are held by brokers for their clients, including individual investors and mutual funds. Still, companies have continued to issue paper certificates as well, primarily to meet requirements in the few states that insisted on physical certificates.

One of those states was Delaware, where more than half of all public U.S. companies are registered. Earlier this year, however, Delaware updated its laws to eliminate the requirement for paper certificates. Since then, several other states that still required paper stock certificates have also updated their laws. As a result, many U.S. companies are likely to begin phasing out paper certificates altogether and relying completely on electronic records. So it seems we are close to the end of an era. Like 'dinosaurs,' paper share certificates are slipping into history. Left behind – finally – will be a paper trail long littered with high costs, high risks and many 'fossils.'//