Department
for Business
Innovation & Skills

TRANSPARENCY & TRUST: ENHANCING THE TRANSPARENCY OF UK COMPANY OWNERSHIP AND INCREASING TRUST IN UK BUSINESS

Discussion Paper

JULY 2013

Foreword

At the G8 Summit in June, the Prime Minister persuaded his G8 counterparts to join him in committing to an ambitious set of reforms to ensure that we know who really owns and controls our companies. These reforms are important. Enhanced transparency of company ownership will help us to tackle tax evasion, money laundering and terrorist financing. It will improve the investment climate and make doing business easier.

Enhanced transparency will also help ensure that businesses, investors, employees and consumers have trust in UK companies. Trust is an essential element of a business environment that encourages investment and growth.

I know that the overwhelming majority of UK companies contribute productively to the UK economy, abide by the law and make an enormous contribution to society. But there are exceptions – and I want to address that.

Government is not alone in recognising the importance of this agenda. Leading figures in the business community acknowledge the importance of transparency and trust. They know that having an effective system for identifying and dealing with poor business behaviour gives confidence in UK companies and helps create an environment in which honest entrepreneurs are willing to invest in activities promoting growth and employment. Businesses and individuals who behave honestly and responsibly should not be placed at a disadvantage by those who do not play by the rules.

At the same time I remain firmly committed to reducing regulation and burdens on business. I am continuing to look at options to reduce administration and compliance costs for businesses as part of Government's ambition to create a streamlined, effective and pro-growth business environment. I will consult on these proposals in the autumn. We will develop these deregulatory measures alongside the proposals in this paper to form a cohesive package of reform.

Enhanced transparency and increased trust are good for business and good for growth. I am wholly committed to this agenda and want to see reforms introduced in this Parliament.

This discussion paper is the first stage in that process. It outlines a range of proposals to enhance the transparency of UK company ownership and increase trust in UK business. The proposals will help prevent illegal activity such as money laundering and tax evasion. They will give investors and others the tools to hold companies to account. They will provide businesses, investors, employees and consumers with confidence that companies are acting fairly – and that those who deliberately or recklessly break the rules will be punished.

The paper is a clear sign of our commitment to ensure that the UK is and remains an open and trusted place to do business and invest. I look forward to hearing your views on how best we can, together, achieve that ambition.

VINCE CABLE

SECRETARY OF STATE FOR BUSINESS, INNOVATION AND SKILLS

Overview of proposals

This paper considers a range of proposals to **enhance the transparency of UK company ownership and increase trust in UK business.** This will help prevent illegal activity; better enable companies to be held to account; and provide businesses, investors, employees and consumers with confidence that companies are acting fairly.

Ensuring that we know who really owns and controls UK companies

At the UK-chaired G8 Summit in June, the UK committed to introduce new rules **requiring companies to obtain and hold information on who owns and controls them;** implement a **central registry of company beneficial ownership information;** and to review the use of **bearer shares** (which do not require the identity of the holder to be entered in the company's publicly available register of members) and **nominee directors** (which can be used to conceal the identity of the person really controlling the company). This paper invites views on the following areas:

- We propose that the registry should hold information on the **beneficial owners** (i.e. on individuals with significant control or influence) **of all UK companies**, but consider whether companies already subject to stringent disclosure rules should be exempt.
- We intend to **give all companies statutory tools** to identify their beneficial ownership; and we consider what **additional requirements** might be required to ensure beneficial ownership information on all companies is indeed obtained.
- We look at **what information** should be provided to the registry; **how frequently** it should be updated; and how to ensure that it is as **accurate** as possible.
- We consider whether information in the registry should be made **public** – noting the strong case for openness but recognising that there may be concerns.
- We propose that the creation of new **bearer shares** should be prohibited; and that existing bearer shares should be converted to ordinary registered shares.
- We consider options to enhance transparency around the use of **nominee directors;** and whether companies should be prohibited from being appointed company directors, i.e. whether we should ban **corporate directors**.

Ensuring that the UK is a trusted place to do business and invest

We think there may be ways to **strengthen the system** for tackling the small minority of **company directors that don't follow the rules**. This is especially important in the light of the company failures during the financial crisis. The paper starts this debate by putting forward a number of proposals:

- Following the Parliamentary Commission on Banking Standards' recommendation that directors of banks should have a primary responsibility to ensure the safety and stability of their firms, we consider whether to **amend directors' statutory duties in key sectors such as banking** and whether to **allow sectoral regulators to disqualify directors** in their sector.
- We consider what **additional factors** the court might take into account in director disqualification proceedings, such as the nature and number of previous company failures a director has been involved in.

- We look at options to help **creditors receive compensation** when they have suffered from a director's fraudulent or reckless behaviour.
- We propose that the **time limit** for bringing disqualification proceedings in insolvent company cases should be extended from two to **five years**.
- We propose directors who have been disqualified should be offered **education or training** to equip them with the skills they need to go on to run a successful company.
- We consider whether individuals subject to **foreign restrictions** should be prevented from being a director of a UK company; and whether directors convicted of a **criminal offence** in relation to the management of an overseas company should be able to be disqualified in the UK.

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Executive summary

The importance of transparency and trust

1. Business success - and therefore economic growth - depends on investors, employees, consumers and the wider public having confidence in business. When companies do business with each other, those transactions must also be built on trust.

2. In the UK, we have a history of championing the importance of good corporate governance – and that trend continues. We are ensuring that equity markets support long-term growth through the implementation of Professor Kay's recommendations. We are working to improve the diversity of UK boardrooms and to encourage companies to focus on the issues that really matter through changes to narrative reporting. And our executive pay reforms, which will come into force in the autumn, have been widely welcomed.

3. These reforms are important – we know that good corporate governance is inherently linked to trust in our capitalist system and that effective governance is therefore a critical characteristic of a business environment that promotes long-term sustainable growth. This in turn makes the UK an attractive place for business and investment.

4. This year the UK is using its Presidency of the G8 to promote this agenda on a global stage, encouraging our G8 partners to take steps to promote improved governance and accountability through increased transparency alongside reforms to the international tax architecture.

5. We know that the overwhelming majority of UK companies contribute productively to the UK economy, abide by the law and make an enormous contribution to society. Companies make up over 60% of private enterprises and over 80% of private enterprise employment and 95% of turnover[1].

6. But there are exceptions. Increased transparency can help shine a light on those who don't play by the rules and pave the way for legitimate investment. Transparency is also an essential element of good corporate governance - it gives investors and others the tools to hold companies to account.

7. Businesses, investors, employees and consumers must have confidence that companies are acting fairly and that those who don't will be identified and appropriately sanctioned. Businesses and individuals who behave honestly and responsibly should not be at a disadvantage to those who do not. Having an effective and trusted system for identifying and dealing with poor business behaviour gives reassurance that we operate a level playing field, and creates an environment in which investors and honest entrepreneurs are willing to invest in activities promoting growth and employment.

[1] IDBR, March 2013

8. This paper sets out a number of proposals **to enhance corporate transparency and increase trust in UK business**. Together, these measures will support the development of a business environment where companies and individuals can operate and invest with confidence.

9. It is intended that the proposals in this paper would apply UK-wide. As some of the policy areas are devolved to Northern Ireland and Scotland, we will work with the Northern Ireland Executive and the Scottish Government to consider the application of these proposals to Northern Ireland and Scotland.

Enhancing the transparency of UK company ownership

10. The vast majority of UK companies abide by the law. But it is a fact that companies can be misused to facilitate a range of criminal activities - from money laundering to tax evasion, corruption to terrorist financing. Greater corporate transparency will make it more difficult to carry out this abuse and act as a deterrent to crime. Where abuse does take place, transparency should help law enforcement and tax authorities identify and sanction the individuals really responsible.

11. We already know who legally owns UK companies. The names of legal owners appear on an individual company's share register, which is publicly available. But if we want to know who *really* owns and controls a company, we must identify its beneficial owners too. The beneficial owners are the individuals that ultimately own or control the company - either because they hold an interest in more than 25% of the company's shares or voting rights; or because they control the management of the company in some other way. With this level of interest or control, they can materially influence corporate decisions, and this confers the potential for abuse, irrespective of whether they own or control the company directly as a legal owner or director or indirectly by using a nominee shareholder or director to own shares or manage the company on their behalf.

12. There is currently no requirement for companies to hold information on their beneficial owners as a matter of course. This means that individuals can hide the fact that they own or control a company; and then use the company to help them carry out a range of illegal activities. It is very difficult to prove that these individuals are linked to the company in question, which decreases the likelihood of a successful outcome for law enforcement and tax authorities.

13. There is a clear correlation between illicit activity and lack of transparency in the ownership and control of companies. For example, in 2011 the World Bank – UN Office for Drugs and Crime Stolen Asset Recovery Initiative reported that 150 of the 213 grand corruption cases investigated involved the use of at least one corporate vehicle to hide beneficial ownership and the true source of funds[2]. In these 150 cases, the total proceeds of corruption were approximately $56.4bn.

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[2] 'Barriers to Asset Recovery', 2011: http://star.worldbank.org/star/publication/barriers-asset-recovery

14. The Financial Action Task Force (FATF) is the international body that sets the standards on combating money laundering and terrorist financing. It recommends that: *"Competent authorities should be able to obtain, or have access in a timely fashion to, adequate, accurate and current information on the beneficial ownership and control of companies and other legal persons*[3]*".* This recommendation is reflected in EU proposals for a 4th Money Laundering Directive[4], currently being negotiated by Member States and the European Parliament.

15. The G8, under the UK's Presidency, has endorsed the need for action and moved this agenda forwards. At the G8 Summit in June, G8 countries agreed a number of core Principles[5] that are fundamental to the transparency of ownership and control of companies and legal arrangements. These Principles underpin individual country Action Plans setting out how the FATF standards will be implemented in their jurisdictions. The UK, as well as the US, Canada, France, Italy and Japan published their Action Plans at the Summit. The UK's Overseas Territories and Crown Dependencies also agreed to publish Action Plans setting out the concrete steps they will take to implement these Principles (some have already done so).

16. **Given the international and cross-border nature of company misuse, collective action at G8, G20 and European Union (EU) level is vital.** That is why we intend that implementation of UK reforms will be through and at the same time as transposition of the 4th EU Money Laundering Directive from 2014 to 2015 and through changes to company law. But as we shape the international debate the UK should be at the forefront of taking practical action to build confidence in the UK business environment.

A central registry of company beneficial ownership information

17. The UK Action Plan[6] states that we will **require companies to obtain and hold information on their beneficial ownership and make this information available to law enforcement and tax authorities through a central registry maintained by the Registrar of Companies** (Companies House). There is a question whether this information should be publicly available – there are clear advantages but also potential concerns. In the UK Action Plan, we set out the intention to consult on this issue.

18. The Money Laundering Regulations 2007[7] **define a 'beneficial owner'** as any individual with an interest in more than 25% of the shares or voting rights of the company; or who otherwise exercises control over the way that the company is run. By applying this definition, the registry would hold information on those individuals able materially to influence the way that the company is run. Throughout this document, we use the term 'beneficial owner' and 'beneficial ownership' in line with this definition.

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[3] 'The FATF Recommendations', February 2012: http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf
[4] 'Proposal for a Directive of the European Parliament and of the Council on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing', February 2013: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52013PC0045:EN:NOT
[5] 'Common principles on misuse of companies and legal arrangements', June 2013: https://www.gov.uk/government/publications/common-principles-on-misuse-of-companies-and-legal-arrangements
[6] 'UK action plan to prevent misuse of companies and legal arrangements', June 2013: https://www.gov.uk/government/publications/uk-action-plan-to-prevent-misuse-of-companies-and-legal-arrangements
[7] 2007, No. 2157: http://www.legislation.gov.uk/uksi/2007/2157/pdfs/uksi_20072157_en.pdf

19. This definition would not allow individuals to evade disclosure requirements by holding a lower level of interest in the company. Where a number of individuals collectively held more than 25% shares and agreed to vote those shares together, for example, they would be treated as one person and considered as the beneficial owner of the company. And if an individual effectively exercised control over the company, they would also be caught by the definition – irrespective of the number of shares (if any) that they held.

20. In terms of **which companies would be in scope** of a registry, our starting point is that beneficial ownership information on **all UK companies** should be held in the registry. However, as companies listed on the Main Market of the London Stock Exchange are already subject to stringent ownership disclosure requirements, we do not think there is additional value in information on their beneficial ownership being held in a central registry. There may be other types of company that should be similarly exempt.

21. We also need to consider whether beneficial ownership information on **other types of legal entity** should be held in a registry. We think, for example, that there is a strong case for the inclusion of Limited Liability Partnerships (LLPs), alongside companies.

22. Central to beneficial ownership reform is **how this information is obtained**. Our starting point is to **give all companies the power to ask detailed questions in relation to their beneficial ownership**. The Companies Act 2006 (CA06) already enables public companies to do this, but not private companies. We then consider what additional obligations might be required to ensure that information on all companies' beneficial ownership is provided to the registry.

23. We must also decide **what information is provided to the registry** and how we ensure that it remains as **accurate and up to date** as possible. We need to give particular consideration to how quickly individuals or companies might be required to update beneficial ownership information held by the company or the registry. The fact that information currently held by Companies House is open to public scrutiny and that it is an offence to provide false information to the registry helps ensure that information held in the registry is as accurate as possible. The question of how we ensure accuracy of beneficial ownership information is therefore linked to the question of **whether it is made public**.

24. We think there is a **strong case for openness**. There are advantages in terms of allowing public scrutiny and ensuring investors, the market and other companies understand better with whom they are doing business. However, we also recognise that there may be legitimate concerns. At a minimum, the information will need to be accessible to specified law enforcement and tax authorities.

Additional reforms to prevent the misuse of companies

25. A central registry of beneficial ownership information will be a significant step forward in understanding who is really behind UK companies.

26. There are two related areas that we must also consider – bearer shares and nominee directors. The G8 Principles on preventing the misuse of companies highlight the importance of preventing: *"[…] the misuse of financial instruments and certain*

shareholding structures which may obstruct transparency, such as bearer shares and nominee […] directors[8]".

27. As noted above, the legal owners of a company are recorded on the company's register of members. However, **bearer shares** provide a way for individuals to avoid having their identity revealed on that register. A company can issue 'bearer shares' which belong to whoever holds the physical share warrant - the company's register will simply record that the shares are held by the bearer of that warrant.

28. Whilst bearer shares may be used legitimately there is also clear scope for misuse. A number of international standards have highlighted the misuse of bearer shares as a way to facilitate tax evasion and money laundering. Bearer shares also permit a level of opacity which is incompatible with the principles of our ambition to know who really owns and controls UK companies. We therefore consider that it may be appropriate to **prohibit the creation of new bearer shares to prevent the potential for misuse.**

29. This highlights the question of existing bearer shares. We think the most appropriate option would be to **provide a set period of time for holders to convert their bearer shares to ordinary registered shares.** This model has been adopted in other countries; and provides a way to ensure full transparency of company ownership without disenfranchising the holders of the shares.

30. **Corporate and nominee directors** can also be used to conceal corporate control. Company directors are registered at Companies House. Where individuals want to use a company to facilitate criminal activity they are unlikely to want to register themselves in this way. They may therefore appoint a **'nominee director'.** The nominee is placed on the register of directors but follows the directions of the person who is really controlling the company (i.e. the beneficial owner). In some cases, the nominee will have no involvement in the management of the company at all – the beneficial owner can simply 'rubber stamp' company documents with the nominee's signature.

31. There are legitimate commercial uses for nominee directors. For example, where a parent company needs to be represented on the board of its subsidiary. **We do not intend to interfere with these kinds of commercial practice.**

32. However, as with bearer shares, there is clear scope for misuse and we think that reform is required to **enhance transparency around their use**. One option would be to require any director who has entered into a legal arrangement which permanently hands over all responsibility for the management of the company to another individual to **disclose this fact to Companies House**; as well as the identity of the person on whose behalf they have been appointed. This should make the use of nominee directors less attractive as a means to conceal corporate control. We would need to consider whether these declarations should be made public.

33. Alternatively, it could be made an **offence for directors to divest themselves of their duties as a director** by signing such legal documents. They might then be subject to

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[8] 'Common principles on misuse of companies and legal arrangements', June 2013: https://www.gov.uk/government/publications/common-principles-on-misuse-of-companies-and-legal-arrangements

disqualification from being a director – forcing the real owner to find another individual willing to break the law in order to continue to conceal their control.

34. Criminals looking to misuse companies will likely want to make the company's ownership structure as opaque and complex as possible. UK company law allows a company to be the director of a company (a **'corporate director'**). Where the corporate director of a UK company is a company incorporated offshore, it becomes very difficult for law enforcement and tax authorities to identify the true beneficial owners of the UK company.

35. Whilst we accept that there are potentially legitimate uses of corporate directors in the UK, we consider that the scope for abuse necessitates action. Various jurisdictions have opted to completely **prohibit corporate directors** and we consider that there is a **case for the UK to do the same**.

Reducing regulation

36. The Government remains committed to reducing regulation and burdens on business. For example, we are developing a number of company law deregulatory proposals following our Company and Commercial Law Red Tape Challenge. These proposals will look to reduce compliance and administrative costs for businesses as part of Government's aim to create a streamlined, effective and pro-growth business environment.

37. We propose to **consult on a range of these deregulatory measures in the autumn.** This paper references where and how some of these deregulatory proposals might interact with how we implement corporate transparency reforms. We will develop corporate transparency reforms alongside possible deregulatory measures to ensure that we deliver a cohesive package of reform.

Increasing trust in UK business

38. The proposed reforms outlined above will enhance the transparency of UK company ownership. This transparency will create an environment where it is more difficult for individuals to abuse the company structure; and easier to identify and sanction those that do.

39. But in looking to create a trusted business environment, greater transparency is only half the story. In parallel, companies, investors, employees and consumers must have confidence that companies and those running them are acting fairly and that those who do not will be dealt with appropriately.

40. Each year around 1,200 directors of companies are disqualified from acting in the management of companies for up to 15 years; and around 90 directors are prosecuted for criminal behaviour in relation to the management of a company. Whilst the latest survey by the Insolvency Service suggested that around 65% of those questioned had

confidence in the enforcement regime[9], its adequacy has been called into question as individuals apparently responsible for major corporate failures have seemingly gone unpunished. This has been a particular issue in the banking sector, leading the Parliamentary Commission on Banking Standards (PCBS) to put forward a number of recommendations designed to improve governance of banks.

41. This paper implements the PCBS recommendation that the Government should consider whether **directors' statutory duties should be amended for those operating in the banking sector** to promote a more responsible approach to managing large financial services companies. We also consider **other options for tackling unacceptable conduct by company directors**, both in key sectors like banking and more widely.

42. We will continue to ensure that these robust powers are used only in appropriate cases - so that honest directors do not need to fear sanctions where they have acted in good faith. Many companies fail for genuine reasons. Failure in itself is not an indication of misconduct. And **responsible risk-taking is an essential element of entrepreneurialism that we need to drive economic growth.**

43. The need for increased levels of trust and confidence extends to the professionals who deal with companies when they go insolvent. The issues of most concern currently to business and consumers are the **use of pre-pack administrations**[10] and the **fees charged by Insolvency Practitioners** (IPs).

44. We are taking steps to address both these issues, in parallel with the proposals in this paper. An **independent review of pre-pack administrations**, headed by Teresa Graham was launched on 15th July. Emeritus Professor Kempson of the University of Bristol has concluded a **review of IP fees.** Her findings were also published on 15th July and we will respond in due course. In addition, we have recently launched a **Complaints Gateway** to make it easier for a consumer or small business to make a complaint about an IP by providing a single point for such complaints. Regulators have also agreed to introduce **common sanctions** against IPs when complaints are upheld. Finally, we are looking to **enhance the powers of the Insolvency Service as oversight regulator** for sanctioning regulators of the insolvency profession where regulatory failure has occurred.

45. In this paper we will explore proposals to identify and deal with poor business behaviour.

Clarifying the responsibilities of directors in key sectors

46. Company law applies to all companies, economy-wide, that fall under the CA06. In addition, companies that operate in regulated sectors have to abide by the laws and rules set out in sector-specific regimes. For banks specifically, the PCBS recommended ways in which both sector regulation and wider company law could be strengthened. This included calling on the Government to consult on changing the

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[9] 'Stakeholder Confidence Survey', Insolvency Service, 2012: http://www.bis.gov.uk/insolvency/About-us/our-performance-statistics/StakeholderConfidence

[10] A pre-pack is where a sale of the business of the insolvent company is arranged shortly before it goes into administration and is executed immediately thereafter, often with little or no marketing on the open market.

statutory duties of directors of large banks[11] so that they are required to prioritise the "safety and stability" of the firm first over the interests of shareholders.

47. The PCBS aim with this recommendation is clear - to ensure that bank directors are never in doubt about their primary responsibility to maintain bank stability. We accept the need for reforms that will have a real impact on bankers' behaviour. This paper therefore implements the PCBS' recommendation to consider whether **directors' duties should be changed for the banking sector.** We also ask whether this should **extend to other key sectors.**

Allowing sectoral regulators to disqualify directors in their sector

48. There are, however, questions as to the effectiveness of changing directors' duties for certain sectors and about the potential wider impacts. This paper therefore considers whether there are alternative ways of strengthening the regulation of directors in certain sectors. One option would be to consider granting appropriate **sectoral regulators the ability to ban people from acting as a director in *any* sector.** This would mean that following a breach of sectoral regulations that cause an individual to be barred from a particular sector, the regulator would be able to extend the ban more widely. In practice, this could be done by extending the powers of regulators such as the Pensions Regulator, Financial Conduct Authority and Prudential Regulation Authority.

Factors to be taken into account in disqualification proceedings

49. Another option to effect behavioural change and thereby enhance trust in both banks and the wider business environment is to consider whether, for all business sectors, we should **widen the factors that can be taken into account by the court when considering whether to disqualify a director or the length of the disqualification period.**
50. When determining whether an individual is unfit to act as a director, the court must take account of matters set out in the Company Directors Disqualification Act 1986 (CDDA). Given the punitive and financial effect disqualification may have upon an individual, the standard of evidence required by the court to determine misconduct is fairly high.

51. The CA06 does not explicitly provide the Secretary of State or the court with the option of considering material breaches of relevant sectoral regulation when deciding whether and for how long to disqualify directors. Yet there is a strong case for arguing that a material breach of sectoral regulations – such as in the banking sector – is incompatible with fulfilling directors' duties as set out under the CA06[12].

52. For these reasons, we are interested in views on whether Schedule 1 to the CDDA should be amended to explicitly allow the court the **option of taking into account material breaches of relevant sectoral regulation.** This could be used to help determine whether directors should be disqualified or the length of the disqualification period.

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[11] Banks over the ring-fence threshold (in line with the recommendations of the Independent Commission on Banking)
[12] 'General duties of directors', Sections 171 to 177, Companies Act 2006, c. 46: http://www.legislation.gov.uk/ukpga/2006/46/contents

53. Similarly, the court, in adopting a proportionate approach to considering whether and for how long to disqualify a person, may take into account the scale of loss suffered by creditors as a result of misconduct and any wider economic or social impacts. There is however no explicit requirement to do so. Given the catastrophic failure of certain firms and the impact this has had on wider society over the last few years, there is a strong argument that **the scale of loss suffered by creditors and the impact on wider society should be explicitly taken into account** when determining whether to disqualify directors and/or for how long.

54. The CDDA is intended to protect creditors and consumers from repeated harmful behaviour by directors by removing such directors from the market for a specific period. We want to ensure that this protective function is enhanced by **ensuring that a director who has displayed a pattern of behaviour resulting in company failure or creditor loss - whether due to incompetence or culpable behaviour - can be prevented from doing so again.** And where a director's misconduct has resulted in **losses to more vulnerable or less sophisticated creditors**, this should be reflected on by the court when deciding on the appropriate action.

Improving financial redress for creditors

55. A complaint frequently heard from creditors is that although disqualification can prevent a director acting as such in future, it provides no compensation to those who have suffered from their misconduct. We need to find ways to increase trust in our regime by ensuring that if directors (and those advising them) act fraudulently or negligently they will run the risk of **needing personally to compensate those who have suffered loss** as a result – and that directors are aware of this.

56. We therefore want to increase the prospects of culpable directors being pursued where they have been responsible for causing or allowing companies to trade wrongfully or fraudulently. Currently, a liquidator may bring a civil claim for fraudulent or wrongful trading against the directors of an insolvent company. However, the liquidator has no right to sell or assign the action in the way they can other assets of the insolvent company. Therefore, if the liquidator does not have sufficient funds to pursue the claim, there will be no way of securing financial redress under these actions for the creditors, however strong the claim.

57. To increase the prospects of culpable directors being pursued, we propose **granting liquidators the statutory right to sell or assign fraudulent and wrongful trading actions.** This would enable a liquidator to sell the claim on to an individual creditor, group of creditors, or possibly even a third party. Creditors would benefit from the proceeds of the sale and the claim would be more likely to be pursued. We anticipate that a market in these actions would develop, and increase the prospect of actions being taken against directors.

58. We also want to explore **giving the court a new power to make a compensatory award** at the time it makes a disqualification order. This would increase the likelihood of culpable directors being called to account for their actions, whilst providing better recourse to creditors who have suffered. There are practical implications of this approach which need to be fully considered. However, we invite views on whether this would increase confidence in the corporate enforcement regime.

Time limit for disqualifications

59. Under the current regime, disqualification proceedings in insolvent company cases must usually be commenced within two years of the first insolvency event. In a small minority of cases where the information about unfit conduct does not come to light until a very late stage or where the case is exceptionally large, complex or time consuming, this time limit might prevent disqualification action. In such cases, the time limit may mean that misconduct is not addressed and so an extension of time would be desirable.

60. One option would be to **remove the time limit completely**. However, this may unfairly impact directors, who would be left in indefinite uncertainty as to the possibility of action being taken against them. Instead, we propose that the **limit be increased to five years.** We envisage that this extended period would only be required in a small minority of cases and the majority of proceedings would continue to be initiated within two years.

Educating directors

61. Where a company has failed, the lessons a director has learnt from being involved in the management of that company might equip them to have another go and make a success of any new business. In other cases, directors may have specific education or training needs which need to be addressed before they can go on to successfully run another company.

62. We think the public interest may be better served by offering directors some form of education or training to help them take positive steps to learn from their previous mistakes. International comparisons suggest that other countries do more to promote ‘bounce back’ from failure.

63. Directors against whom disqualification action is to be taken could therefore be offered the opportunity of undertaking some form of **education or training which would result in a reduction of the length of their disqualification period.** Additionally, a disqualified director could be required to undertake training before being able to obtain the court’s permission to act in the management of a specific company whilst disqualified.

Extending overseas restrictions

64. A person who is disqualified or who has been convicted of a criminal offence in connection with the management of a company overseas is not currently prevented from acting as a director of a UK company. Although this would apply to a small number of cases from a certain range of countries, it leaves open the possibility of unfit persons being able to operate as directors of UK companies.

65. Not only are the savings from disqualification, as set out above, noteworthy, but we also want the business community, consumers and investors to trust our corporate regime and have confidence that individuals who have been found unfit to manage companies overseas are not able to set up and run companies here.

66. It is therefore crucial that individuals who are unfit, and have been deemed so in another jurisdiction, are not permitted to run a UK company. At the very least, those dealing with limited companies ought to be able to **check that officers of the companies with whom they deal are not subject to restrictions** that would prevent them from running companies elsewhere.

67. We propose to go further, and to use existing powers in the CA06 to make regulations that would **prevent a person who is subject to foreign restrictions from being a director of a company in the UK.** These regulations could provide for a foreign restriction to apply in the UK automatically or, alternatively, only after an application has been made to the court for a finding of unfitness. It would also be possible to make different provision in different cases having regard to the nature of the foreign restriction, the conduct in question and the country where the restrictions were imposed.

68. We also propose to amend the CDDA to **enable disqualification proceedings to be brought against any individual who has been convicted of a criminal offence in connection with the management of a company overseas**, if it would appear to be in the public interest to do so.

Reducing regulation

69. As noted above, we remain committed to reducing regulation and burdens on business. As part of the Government's Red Tape Challenge we initiated discussions with interested parties and identified a number of ways to improve our insolvency processes, making them simpler and less burdensome. One proposal is to **streamline the way in which insolvency practitioners report possible misconduct by directors** after a company has entered a formal insolvency procedure. This would mean a simpler and more timely reporting process as part of a more intelligence-led approach to prioritising cases for investigation. Other measures would simplify a range of processes in insolvency law. A consultation on these specific proposals will be published very soon.

70. In addition to this, the Deregulation Bill - a draft of which has been published for pre-legislative scrutiny - will **give insolvency investigators greater powers to request relevant information from any person**, including the directors they are investigating. Currently, investigators have to rely on asking the company's liquidator or administrator to make such enquiries which is inefficient and burdensome to all parties.

Timing and next steps

71. This discussion paper will be open for comment until **Monday 16th September**. Once responses have been received and analysed, including any estimates of the economic impacts of the proposals from consultees, we will issue a Government response.

72. That response will consider how reforms might be implemented. Some changes in this paper would require primary legislation. We would therefore look to secure an appropriate legislative vehicle. Other changes might be taken forward through UK

implementation of the EU's anti-money laundering proposals. Where possible, we will look to introduce reform before the end of this Parliament.

73. The proposals in this paper relate to companies incorporated in the UK, their directors and their owners. Some proposals might also impact other types of legal entity, such as Limited Liability Partnerships. We welcome responses from companies, directors and investors; industry representative bodies; professional bodies such as law firms and insolvency practitioners; and other interested parties.

74. Details on how to respond to this paper are provided on page 87.

Part A: Enhancing the transparency of UK company ownership

Introduction

1.1. Companies are an integral part of the business landscape. Some companies carry out activities on an ongoing basis – producing goods or providing services. Others are formed for a specific or single purpose and may then be dissolved – for example, to support a particular financial transaction. Some companies will have very simple ownership structures. Others are necessarily more complex.

1.2. There are a number of benefits to forming a company. For example, because the company is treated in law as a legal 'person', there is a separation between the company and its owners. This means that the company can enter into contracts and business relationships in its own name; that the individuals owning the company have limited liability for the company's debts[13]; and that those entering into a relationship with the company need not worry about the financial standing of the company's directors and shareholders.

1.3. Companies must comply with the regulations and reporting requirements set out in UK company law. This body of law is well established and well regarded. The UK regime is also transparent. Central to this is the provision of information to the Registrar of Companies (Companies House). Companies House receives information from companies and (with limited exceptions[14]) places it on the public record. A key part of this is ensuring that accounts and annual returns are delivered for every UK company. Compliance rates for those documents – 98% for annual returns and 99% for accounts – are the best they have ever been and amongst the best in the world.

1.4. But we continue to consider **additional means to ensure that companies comply with all of their statutory filing requirements**. For example, companies are required to report certain information about their subsidiaries to Companies House. Further to reports that some companies were not providing this information, Companies House has committed to implement changes to its enforcement regime.

1.5. This will initially focus on FTSE 350 companies[15]. Companies House will check their accounts and, where necessary, the subsequent annual return to ensure that the company has supplied a list of its subsidiaries. If the list is missing, Companies House will contact the company and ask for this information to be provided.

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[13] If that company is a limited liability company.
[14] For example, directors' residential addresses are protected from disclosure (see Chapter 8 of the Companies Act 2006, c. 46: http://www.legislation.gov.uk/ukpga/2006/46/part/10/chapter/8).
[15] The FTSE 350 is a stock market index which incorporates the largest 350 companies listed on the London Stock Exchange.

1.6. This will help us understand the costs and benefits of moving permanently to such a process, including of applying this type of enforcement regime to a wider range of accounts compliance issues. Companies House will report on the outcomes and findings at the end of July 2013.

1.7. In spite of our robust regime, there will always be those who seek to misuse companies. Individuals can use a company to conceal their identity and facilitate a range of criminal activity, from money laundering and terrorist financing to sanctions and tax evasion. They might conceal corporate ownership and control by:

- Using other individuals or companies to be the legally registered holder of shares on their behalf and concealing their **beneficial ownership** of those shares;
- Holding **bearer shares** which do not require the identity of the owner to be disclosed on the company's register of members; or
- Appointing **nominee or corporate directors** as the director of the company to conceal their involvement in the management of the company.

1.8. There are already ways to help identify who ultimately owns and controls companies. Law enforcement authorities have statutory powers to require disclosure of information and regulated entities (banks, lawyers and other professional bodies, as designated by the UK anti-money laundering framework[16]) are required to identify the beneficial owners of companies before entering into a business relationship.

1.9. However, we think that there is potential to reduce further the scope for misuse and, where misuse does take place, to improve the ease with which those who break the law can be identified and sanctioned.

1.10. Part A of this paper accordingly considers options for reform.

[16] See regulations 3 and 4 of the Money Laundering Regulations 2007, No. 2157: http://www.legislation.gov.uk/uksi/2007/2157/contents/made

A central registry of company beneficial ownership information

Defining 'beneficial ownership'

2.1. In a **narrow sense**, beneficial ownership refers to the individuals who ultimately own or control the shares in a company limited by shares. An individual might directly own shares in the company, i.e. in their own name[17] and not on behalf of anyone else. Here there is no distinction between the legal and beneficial owner. Alternatively, another individual or organisation might own shares in the company on their behalf. Here the legal and beneficial owner are two separate people.

2.2. In its **broadest sense**, beneficial ownership also includes the idea of control of the company and its activities for the benefit of a person. The beneficial owners are the individuals that ultimately control the way the company is run – whether or not they have any interest in the shares of the company. This is why we can talk about the beneficial ownership of a company or other legal entity that does not have shares, e.g. a company limited by guarantee.

2.3. Throughout this paper we will use 'beneficial ownership' and 'beneficial owner' in the broadest sense. This is in line with the definition used in international standards and the UK anti-money laundering framework[18].

2.4. The number of beneficial owners (who are not also legal owners) of UK companies is uncertain. One estimate is of 410,000, with a further 69,000 new beneficial owners per year[19].

The scope for misuse

2.5. Company law requires certain information on company directors and the registered legal owners of company shares to be made publicly available. However, there is currently no requirement for all companies to obtain and hold information on their beneficial ownership as a matter of course. People who want to use a company for unlawful activities can use this opacity to hide the fact that they own or control a company. They may then use the company for the purpose of corruption, money laundering, tax evasion or terrorist financing, or to avoid financial sanctions or conceal stolen assets.

2.6. There are currently circumstances in which a company's beneficial owners should already be identified. For example, banks, lawyers, accountants and other

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[17] The direct owner of a company's shares is referred to as the 'legal owner' of the shares. Legal owners are listed in the company's register of members (also referred to as the 'register of shareholders' in the context of companies limited by shares).

[18] The Financial Action Task Force International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation define a beneficial owner as: *"[…] the natural person(s) who ultimately owns or controls a customer and/or the natural person on whose behalf a transaction is being conducted. It also includes those persons who exercise ultimate effective control over a legal person or arrangement"* (February 2012). See also Regulation 6 of the Money Laundering Regulations 2007, No. 2157: http://www.legislation.gov.uk/uksi/2007/2157/regulation/6/made

[19] 'Costs of beneficial ownership declaration', J Howell for Global Witness, April 2013: http://www.globalwitness.org/sites/default/files/library/Cost%20of%20Beneficial%20Ownership%20Declaration%20Report.pdf

professional bodies[20] ('regulated entities') are required to apply customer due diligence measures before entering into a business relationship with a company. This includes identification of the beneficial owner(s). In respect of companies listed on the Main Market of the London Stock Exchange, individuals with 3% or more of the voting rights in a company must disclose this to the market and the regulator.

2.7. In addition, law enforcement authorities have statutory powers of investigation which they can use to try and identify beneficial ownership. However, where illicit activity is suspected it can be very difficult to prove that the person suspected of benefiting from the shares or company in question is actually the beneficial owner. Law enforcement agencies say that current beneficial ownership arrangements are a significant barrier to tackling money laundering and successfully recovering stolen assets.

2.8. For example, at any one time in the 2012/13 financial year, the Serious Organised Crime Agency (SOCA) was involved in over 400 significant operations. Nearly all of these had a financial investigation element – and it is estimated that in around 70% of such investigations issues around beneficial ownership arise. Similarly, last year SOCA had approximately 60 cases where civil recovery powers were used to retrieve criminal assets. Again, beneficial ownership issues arose in about 70% of those cases. The Serious Fraud Office (SFO) has stated that establishing the beneficial ownership of assets is almost always a key element of confiscation investigations.

2.9. Enhanced transparency of company beneficial ownership should make it easier to identify – and therefore prove – who ultimately owns and controls companies. This should have a positive impact on the efficiency and effectiveness of law enforcement investigations, and a positive outcome in terms of successful prosecutions and confiscation orders.

2.10. This domestic need for reform is part of the growing international consensus that coordinated, cross-border action is required to enhance transparency of company ownership to tackle the potential misuse of companies for illicit purposes.

The need for change

2.11. The Financial Action Task Force (FATF)[21] is the international body that sets the global standards to combat money laundering and terrorist financing. It revised these standards in 2012[22]. The new standard on beneficial ownership says that: *"Competent authorities should be able to obtain, or have access in a timely fashion to, adequate, accurate and current information on the beneficial ownership and control of companies and other legal persons".*

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[20] See regulations 3 and 4 of the Money Laundering Regulations 2007, No. 2157: http://www.legislation.gov.uk/uksi/2007/2157/contents/made
[21] 'About Us', The Financial Action Task Force, June 2013: http://www.fatf-gafi.org/pages/aboutus/
[22] 'International Standards on combating money laundering and the financing of terrorism and proliferation': The FATF Recommendations, February 2012: http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf

2.12. Investigations into abuses of company structures will often cross borders and so coordinated international action is vital. In February this year the European Commission published proposals for its 4th Money Laundering Directive[23] to implement the new FATF standards, including the standard on beneficial ownership. This means that in the UK, we intend that beneficial ownership reform will be taken forward through and in parallel to this Directive, which is expected to be adopted by early 2014.

2.13. The G8, under the UK's Presidency, has endorsed the need for action and moved this agenda forwards - not only to tackle the threat of illicit finance, tax evasion and corruption, but also to maintain the reputation of G8 economies as stable and clean places to do business and invest. At the G8 Summit in June, G8 countries agreed a number of core Principles that are fundamental to the transparency of ownership and control of companies and legal arrangements[24]. These Principles serve to inform individual country Action Plans setting out how the FATF standards would be implemented in their jurisdictions. The UK, as well as the US, Canada, France, Italy and Japan published their Action Plans at the Summit; as did the UK Crown Dependencies and some of the Overseas Territories[25].

2.14. In respect of beneficial ownership, the UK Action Plan commits to implement the G8 Principles by introducing new rules requiring companies to obtain and hold information on their beneficial ownership, and by implementing a central registry of this information. The UK has also committed to consult on whether this information should be made publicly available.

2.15. There are a number of economic reasons for change. As noted above, the current lack of transparency around the beneficial ownership of companies can generate considerable cost and effort for law enforcement investigations. A central registry should give law enforcement and tax authorities a first port of call to identify information that may be of assistance to their investigations, without risking tipping-off the company or beneficial owner that they are under investigation (and thereby giving them chance to evade detection). It should also help these authorities carry out more effective and efficient investigations and proceedings; resulting, for example, in fewer contested court hearings in restraint proceedings and narrowing the issues in confiscation proceedings.

2.16. Also currently there is arguably a misallocation of resources because investment takes place in a company that the investor might not choose to do if they had full information. Alternatively an investor might not invest because the lack of information creates uncertainty around accountability, stakeholder rights and the company operating in the interests of its shareholders[26]. There are also economic

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[23] 'Proposal for a Directive of the European Parliament and of the Council on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing', February 2013: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52013PC0045:EN:NOT
[24] 'Common principles on misuse of companies and legal arrangements', June 2013: https://www.gov.uk/government/publications/common-principles-on-misuse-of-companies-and-legal-arrangements
[25] 'UK action plan to prevent misuse of companies and legal arrangements', June 2013: https://www.gov.uk/government/publications/uk-action-plan-to-prevent-misuse-of-companies-and-legal-arrangements
[26] 'Beneficial Ownership and Control, A comparative study – disclosure, information and enforcement', E.P. M Vermeulen, OECD, 2013

implications from crime such as the loss of life and earnings from terrorist activities; the wider damage to the integrity of the financial system (e.g. due to money laundering)[27]; and more generally a net loss in social welfare from crime[28].

2.17. In order to put an effective and proportionate framework in place there are a number of policy questions that we now need to address. These are outlined below, and we welcome views on our proposals.

(1) The information to be held in the registry

2.18. FATF defines a 'beneficial owner' as the natural person who ultimately owns or controls a legal person or arrangement[29]. The proposed EU Money Laundering Directive interprets this as the individual who owns or controls 25% plus one share of the entity through direct or indirect shareholding; or who exercises control over the management of the entity through other means. This corresponds to the current definition in the UK anti-money laundering framework[30]. The threshold is set at more than 25% because this is the point at which an owner could have a blocking minority in certain company decision-making processes. It is however possible the threshold could be changed through the negotiation of the Directive.

2.19. Using this criterion, a company may have one or more 'beneficial owners'. For example, there could be two individuals owning more than 25% of the company's shares – each able to wield substantial influence; and with neither subject to any other form of control.

2.20. **We think this definition should apply in respect of the information to be held in the registry.** It is important to remember that:

- The registry would hold information on individuals with a cumulative interest in more than 25% of the company's shares or voting rights – including where this interest was held through dispersed shareholdings or through an agreement to act in concert[31] with another individual or individuals. This means, for example, that if three people had an interest in 30% of the company's shares between them and had agreed to vote their shares in the same way; they would, collectively, be a beneficial owner of the company and their interest in the company would need to be disclosed.

- The registry would hold information on individuals who 'otherwise exercise control' over the company - irrespective of whether or how many shares they hold. At a minimum, this would include any individual who had at least as much influence as an individual owning more than 25% of the shares or voting rights in the company.

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[27] OECD, 2013
[28] 'Cost benefit analysis for crime prevention', J Roman, J Farrell, CPS, 2002
[29] 'Legal person or arrangement' covers companies, as well as partnerships, trusts and other corporate bodies.
[30] The Money Laundering Regulations 2007, No. 2157: http://www.legislation.gov.uk/uksi/2007/2157/regulation/6/made
[31] "Persons acting in concert comprise persons who, pursuant to an agreement or understanding (whether formal or informal), co-operate to obtain or consolidate control (as defined below) of a company or to frustrate the successful outcome of an offer for a company. A person and each of its affiliated persons will be deemed to be acting in concert all with each other." (The Takeover Code, 2013: http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/code.pdf)

- Regulated entities would still be required to carry out due diligence checks into the beneficial owners of companies for the purpose of anti-money laundering. They are required to consider individuals with an interest of less than 25% in a company where appropriate, in line with a risk based approach.

We welcome views on:

- The proposed definition of beneficial ownership and its application in respect of information to be held by a central registry?

(2) Companies within scope of the registry

2.21. FATF requires competent authorities to be able to access beneficial ownership information in relation to legal entities, such as companies; and legal arrangements, such as trusts. The UK is committed to the full implementation of this requirement. This discussion paper focuses on the requirement as it applies to legal entities.

2.22. **We think that a registry should hold information on companies incorporated in the UK.** We think, for example, that there is a strong case for the inclusion of Limited Liability Partnerships (LLPs). We will consider further whether there are other legal entities that currently provide information to Companies House which should also be in scope.

2.23. We cannot require overseas companies operating in the UK to disclose beneficial ownership information to a UK registry. This emphasises the need for coordinated action at EU and global level. We will continue to press for this, particularly in the context of EU anti-money laundering proposals.

2.24. We have considered whether some companies should be exempt from the requirement to provide this information to a registry. Public companies listed on a regulated market (i.e. the Main Market of the London Stock Exchange) are subject to stringent disclosure rules by the Financial Conduct Authority (FCA). They are therefore exempt from current EU proposals on beneficial ownership. **Our provisional view is that there would not be added value in additional information about the beneficial ownership of these listed companies being held in a central registry.** There may also be other types of companies that should be exempt.

2.25. On this basis, the number of entities potentially affected by the requirement is around 2.5m[32] (excluding listed companies and including LLPs). Of these, around 2.3m are small companies.

[32] Bureau van Dijk, see: http://www.bvdinfo.com/Home.aspx?lang=en-US

We welcome views on:

- The types of company and legal entity that should be in scope of the registry.
- Whether there should be exemptions for certain types of company? If so, which?

(3) Obtaining information on beneficial ownership

2.26. Part 22 of the Companies Act 2006 (CA06) already enables a public company, if it wishes, to identify individuals with an interest in its shares, i.e. its beneficial owners. Individuals must confirm or deny their interest in the company's shares in response to a request from the company. Where the ultimate owner of the shares cannot be identified, the company may apply to the court to subject the shares to restrictions (for example, the suspension of dividends).

2.27. **We mean to extend Part 22 to all companies, including private companies**. This would provide all companies with the tools to identify beneficial ownership. However, this alone may not be sufficient to ensure that beneficial ownership information would be obtained for all companies. We must therefore consider what additional requirements might be required.

Requiring companies to establish their beneficial ownership

2.28. In order to ensure that beneficial ownership information is actually obtained and held by companies, **we are considering placing a requirement on companies to identify the beneficial owners of any block of shares representing more than 25% of the voting rights or shares in the company; or of any block of shares which would give the beneficial owner equivalent control over the company in any other way.** These requirements might also apply where the company knew or suspected that a group of owners were acting together so that they effectively owned or controlled such a block.

2.29. The company might use its (new) statutory powers under Part 22 to obtain this information. They might equally obtain it by other means, as some companies will already know their beneficial ownership. For example, they might have provided this information to a regulated entity for the purpose of money laundering checks, or the company's directors may be the legal owners of the company (and know that there are no other interested parties). There are around 1.5m companies with a single shareholder; and analysis suggests that over 75% of these shareholders are individuals, rather than companies. In these cases, we think it should, in most instances, be relatively straight-forward for the company to identify its beneficial ownership.

2.30. It is important to note that if the company chose to use the (new) statutory powers to obtain this information, the **individual would be required, under the provisions of Part 22, to respond to the company's request.** As is currently the case, it would be an offence for an individual not to respond or to provide false information.

2.31. If the company was unable to identify the beneficial owner of its shares, the company could (under the provisions of the CA06) apply to the courts for the rights associated with those shares to be suspended. We might additionally **require the company to declare that fact to Companies House.**

Requiring beneficial owners to disclose their interest

2.32. Placing the above requirement on companies may not be sufficient to identify all the beneficial owners of every company. For example, an individual might hold a cumulative interest in more than 25% of the company's shares because they have a number of interests held through a number of legal owners. But this might not be apparent to the company just from identifying who has beneficial ownership of significant blocks of shares. Similarly, without the company knowing, a group of individuals might decide to act together in a way that would bring their combined beneficial holding to above 25%.

2.33. **We are therefore minded to also require beneficial owners to disclose the fact that they are the beneficial owner of the company to the company.** This would be modelled on the disclosure regime that currently applies to any individual with an interest in 3% or more of a company listed on the Main Market of the London Stock Exchange. It would help ensure that individuals who cumulatively or effectively owned or controlled the company other than through a single block of shares would be identified. Failure to make the disclosure would be an offence.

2.34. To help individuals work out their level of interest in a company – and raise awareness of the need to provide this information - companies would as now continue to disclose publicly their total number of shares and the total number of voting rights on at least an annual basis.

We welcome views on:

- Extending Part 22 of the CA06 to all companies as an aide to beneficial ownership identification by the company?
- Placing a requirement on the company to identify the beneficial ownership of blocks of shares representing more than 25% of the voting rights or shares in the company; or which would give the beneficial owner equivalent control over the company in any other way?
- Placing a requirement on beneficial owners to disclose their beneficial ownership of the company to the company?
- Whether there are additional or other requirements we could apply to ensure that information on all companies' beneficial ownership is obtained? If so, what?

Trusts

2.35. The ownership structures of some companies will include express trusts[33]. For example where a parent (the trustee) holds shares on behalf of their child (the beneficiary). The current UK anti-money laundering framework[34] makes clear that in the case of trusts, both the beneficiary of the trust and the person who has control over the trust are beneficial owners.

2.36. On this basis, where the express trust has an interest in more than 25% of the shares or voting rights in a company, or otherwise exercises control over the management of a company, we think that **the trustee(s) should be disclosed as the beneficial owner of the company.** We might also require the **beneficiary of the trust to be disclosed as the beneficial owner in certain circumstances.** Possibilities would include requiring disclosure of beneficiaries if they have express power to control the trust's acquisition or disposition of the shares; the way in which the trust exercises the rights associated with the shares; or the way in which the trust otherwise controls the company.

We welcome views on:

- Requiring the trustee(s) of express trusts to be disclosed as the beneficial owner of a company?
- Whether it would be appropriate for the beneficiary or beneficiaries of the trust to be disclosed as the beneficial owners as well? Under what circumstances?

Supporting investigations by law enforcement and tax authorities

2.37. Where law enforcement and tax authorities are investigating allegations of tax or financial sanctions evasion they may need to identify individuals who have an interest in a small percentage of shares in the company (i.e. less than 25%). Currently the authorities may impose a production order on a company or individual to require this information. However, they may need to obtain repeated production orders to find the individual at the bottom of the ownership chain, i.e. the beneficial owner. This can take time, and is particularly difficult when information must be obtained from a foreign jurisdiction. The current process may ultimately allow the individuals to evade detection.

2.38. In such cases it would be more efficient for the authorities to be able to exercise these investigative powers without the need to first obtain a court order. Under the Companies Act 1985, inspectors acting on behalf of the Secretary of State can investigate company ownership; obtain information on individuals interested in shares; and question company employees without a court order[35]. We therefore

[33] Express trusts allow for the automatic passing of title to property upon the death of the person who set up the trust, also known as the 'settlor'. The trust is frequently utilized in conjunction with a will which directs that any property not already contained in the trust be placed into the trust upon the settlor's death.
[34] The Money Laundering Regulations 2007, No. 2157: http://www.legislation.gov.uk/uksi/2007/2157/regulation/6/made
[35] Sections 442 and 444 of the Companies Act 1985, c. 6: http://www.legislation.gov.uk/ukpga/1985/6/contents

think these **investigative powers should be extended to specified law enforcement and tax authorities.** The bodies permitted to use these powers would need to be set out in legislation.

We welcome views on:

- Extending the investigative powers in the Companies Act 1985 to specified law enforcement and tax authorities?

(4) The central registry

2.39. In the UK's G8 Action Plan, we committed to the implementation of a central registry of company beneficial ownership information maintained by Companies House. This means that beneficial ownership information will, in future, form part of the information that companies are statutorily required to provide to the Registrar of Companies; and that the Registrar is statutorily required to receive and place on the register.

2.40. We need to consider what information companies must obtain on their beneficial owners; and what information they must then provide to the central registry.

2.41. Companies must already hold, at their registered office, information on the legal owners of their shares, including their name, address and the shares that they own. This information forms the company's register of members.

2.42. Companies must also provide some of this information to Companies House. They must provide a full list of their members, including their name, address and information on the shares that they hold, on incorporation. On its first return after incorporation and subsequently on every third return, the company must provide a full list of the names of its members – and addresses in the case of those members having more than a 5% holding in companies whose shares are traded on certain markets. A company must also inform Companies House of any changes to their members' shareholdings in years where a full list is not required.

2.43. **We could use this as the model for beneficial ownership information.** This would mean that companies would be required to hold details of the names and addresses of their beneficial owners; as well as details of the shares in which they had an interest. They would be required to provide the names of their beneficial owners to Companies House on incorporation and periodically thereafter. This would ensure consistency with the regime that applies in respect of legal ownership. This would seem proportionate and might facilitate the familiarisation process by companies.

2.44. If the company was unable to identify any of its beneficial owners, it might be required to declare that fact to Companies House too. We will consider further what action might be taken in relation to such declarations.

We welcome views on:

- Using the requirements that apply in respect of a company's legal owners as the model for beneficial ownership information to be provided to the company and the registry?
- If not, what additional or other information we might require? How?

Accuracy of information

2.45. It will be important that information obtained by the company and provided to the registry is as accurate as possible. We need to consider carefully the extent to which the company is responsible for this.

2.46. Section 1112 of the CA06 would apply in respect of information provided by the company to Companies House. This provides that it is an offence for a person to knowingly or recklessly provide false or misleading information to Companies House. This means that if the company provided beneficial ownership information that it knew to be false, or which was patently false, the company could be sanctioned.

2.47. The fact that the majority of information held by Companies House is open to public scrutiny also helps to ensure its accuracy. The question of how to ensure that the registry holds beneficial ownership information that is as accurate as possible is therefore linked to the question of whether that information should be made available publicly. This is considered further from paragraph 2.55 below.

2.48. If the information is not to be made public we may need to consider whether additional measures are required to ensure the integrity of information in the registry. This would have significant implications for **all** information held by Companies House, not just beneficial ownership information. We would need to consider whether the potential benefits of validation checks would outweigh the potential disadvantages of making it more difficult to incorporate and operate a company in the UK.

2.49. It is important to remember that regulated entities would still be obliged to carry out checks into beneficial ownership before entering into a business relationship with a company. In addition, law enforcement agencies would be able to use their statutory powers of investigation if they had significant concerns about any information held by a company or provided to Companies House.

We welcome views on:

- Whether there is a need to introduce additional or other measures to ensure the accuracy of the beneficial ownership information that is filed with Companies House and retained on the register? If so, what?

- To what extent would the benefits of these measures outweigh the costs and other impacts?

Currency of information

2.50. It will also be important that beneficial ownership information held by the registry is as up to date as possible. As noted above, we might **use the regime for legal ownership as a model**. This would require the company to provide information on its beneficial owners to Companies House on incorporation; to update this list annually with any changes; and provide a full list every three years. Companies might need to carry out investigations into their beneficial ownership at these points to ensure that information provided to Companies House was current.

2.51. However, many companies will have stable beneficial ownership that changes very infrequently. It might therefore be more proportionate to **require companies to update beneficial ownership information at Companies House as it changes**, rather than at regular fixed intervals. This might also be a more effective means of ensuring that information in the registry remained current.

2.52. We would need to consider carefully how to ensure that companies were made aware of beneficial ownership changes and able to report them to Companies House. In some cases it would be evident. For example, where the legal ownership of a significant block of shares changed hands, this should prompt the company to check whether the beneficial ownership of that block had also changed.

2.53. In other cases the change might not be immediately apparent to the company. For example, where the beneficial owner of the shares changed but the legal owner remained the same. **We might therefore require beneficial owners to disclose, within a certain number of days, when they become, or cease to be, a beneficial owner of the company; and when any of the information required to be held by the company or the registry changes** – for example, if they change their address.

2.54. We will however need to consider these questions further in view of wider possible changes to company law. For example, as part of our wider review of possible deregulatory measures we intend to consider the future of the annual return; and whether the requirement is still necessary in its current form. Any changes would likely affect how companies provide and update beneficial ownership information held in the registry; and so we will need to consider the two proposed reforms in parallel.

We welcome views on:

- Whether companies should be required to update beneficial ownership information at fixed intervals or as the information changes?
- Whether beneficial owners should be required to disclose changes in beneficial ownership information proactively to the company?
- The appropriate timeframes for notification of changes to the company or Companies House?

The future of the annual return

Currently all companies are required to submit an annual return to Companies House which confirms certain information about the company. This includes the details of the directors; the location of the registered office; and details of share capital and legal owners. The economic rationale for the current requirement is in terms of ensuring information is available to all parties about legal ownership and company control such that, for example, optimal investment decisions can be made.

However the CA06 already requires much of this information to be updated in-year, within a few weeks of the change having taken place. The annual return therefore primarily acts as a safety net to ensure that companies have an opportunity to review, and if necessary update, their information at a fixed point each year. We would expect that the majority of companies would have updated their information throughout the year as they are statutorily required to do.

In view of our commitment to reducing unnecessary duplication and burdens on business, we are therefore considering possible changes to the annual return process. All companies would be affected by any such changes. There are approximately 3m companies in the UK, of which over 95% are small and micro businesses.

The proposal would be to **simplify the filing requirements for all companies whilst ensuring that the register remains up to date**. There are a range of options for doing this and we intend to issue a full consultation in the autumn. The consultation will balance the impact on both those filing and those accessing information.

Options might include whether companies should be able to choose to combine a new approach to the annual return with the filing of annual accounts. This would mean that they would only need to make only one annual update. Robust mechanisms, including appropriate sanctions, would be needed to ensure that companies continued to provide and update information held by Companies House.

At the same time we will look at other proposals to reduce the duplication of information required from companies by different government departments and agencies.

The **costs and benefits** of reform would clearly depend on what companies would need to do differently – there is unlikely to be any change in the amount of information the companies would need to gather, merely in how it has to be reported. The costs to companies of such changes would primarily be in terms of time, for upfront familiarisation costs and process changes. The benefits would be ongoing cost savings, potentially for both the company and their accountants or agents as a result of simpler ways for them to meet their statutory filing obligations. Given the large number of companies affected, the one-off costs and ongoing savings would both likely be in the order of many £millions, even if the impact per company was small. However, the **net impact** is highly uncertain. Public sector costs and savings would be those incurred by or accruing to Companies House. There would be one-off costs around changes to their processes as well as potentially ongoing savings from improved electronic services and a possible reduction in the number of filings.

In advance of the formal consultation, we welcome views and estimates on:

- The broad possible costs and benefits of a policy change to the annual return.

(5) Making information publicly available

Information held by the registry

2.55. Information held by Companies House is largely available for public inspection. This contributes to the creation of a transparent business environment. We consider that there are benefits to making beneficial ownership information held in a registry similarly available. There are a number of options:

- Information might **only be accessible to law enforcement and tax authorities.** This would be similar to provisions for company directors' residential addresses, which are not placed on the public register by Companies House but may be accessed by specified organisations on request.

- It might also be **accessible to regulated entities**. This would provide them with a central source of information to help them carry out their customer due diligence checks.

- It might be **publicly available**. This would allow public scrutiny of the information – increasing the likelihood of errors or inaccuracies being spotted and therefore contributing to the integrity of beneficial ownership information held by Companies House. It would support wider Government objectives on transparency and good corporate governance by allowing investors, the market and other companies to understand better with whom they are doing business. It would also contribute to other transparency initiatives such as the Extractives Industry Transparency Initiative (EITI), which recommends that implementing countries (of which the UK is one) maintain a publicly available register of the beneficial owners of companies involved in extractives[36].

2.56. We recognise that there may be some concerns about the impact on companies and UK competitiveness as a result of public disclosure. Companies may have

[36] See 3.11 of The EITI Standard, May 2013: http://eiti.org/files/EITI%20STANDARD-screen-version.pdf

concerns about the way in which information would be used; and about an adverse economic impact on their business if people do not want to be associated with the company's beneficial owner (even if that individual is entirely law-abiding). Some law-abiding investors and businesses may prefer to operate in jurisdictions which do not make this information public.

2.57. On balance we think that **making beneficial ownership information in the registry available publicly may help us to derive maximum benefit from the information.**

We welcome views on:

- Whether information in the registry should be made available publicly. Why? Why not?
- If not, whether the information should be accessible to regulated entities. Why? Why not?

2.58. We recognise that some beneficial owners may also have concerns about this information being publicly available. Vulnerable individuals may feel at risk if their personal information is put on the public record. For example, the beneficial owners of companies that operate domestic violence shelters or carry out animal testing may be put at risk if their involvement in the company is known publicly.

2.59. If we were to make information in the registry available publicly, we might therefore **introduce a framework of exemptions for vulnerable individuals**. Individuals might request that information is not placed on the public record where there is a risk to their safety or well-being. There may also be other circumstances in which information would need to be exempt from public disclosure.

2.60. Whilst no exemptions framework currently exists for the legal owners of a company, beneficial owners may deliberately have chosen to hold shares through an intermediary to protect their involvement with the company from being known, for legitimate reasons. We think there is therefore a greater case for an exemptions framework in respect of beneficial ownership.

We welcome views on:

- Whether a framework of exemptions should be put in place? If yes, which categories of beneficial owners might be included? How might this framework operate?

Information held by the company

2.61. It is also necessary to consider what information companies should be required to hold on their beneficial ownership; and whether they should be required to make this information available publicly. We might, for example, opt to make beneficial ownership information held by the company available publicly, even if information held by the registry was not. We will similarly need to consider whether any framework of exemptions that applies to information held by the registry should also apply to information held by the company.

2.62. Companies are currently required to hold their register of members (i.e. legal owners) at their registered office and make this information available publicly. As explained in paragraph 2.50 above, a copy of this information must be provided to Companies House on incorporation; and the names of the members provided periodically thereafter. Companies may choose to make their register available at a location other than their registered office but this location must be declared to Companies House. **We could apply the same model to beneficial ownership information held by the company.**

2.63. An alternative option would be to use the **model that currently applies in respect of information obtained by public companies under Part 22 of the CA06**. Section 808 requires the company to keep a register of information received in response to its requests, and to make it available for inspection.

2.64. However, as we have noted above, the Government is committed to reducing regulation and streamlining the business environment. We therefore intend to consider whether, as part of our deregulatory measures, we should allow private companies the option of making their company registers, including their register of members, publicly available at Companies House instead of at their registered office.

The register of members

We think that requiring companies to make information available at their registered office and via Companies House may be an unnecessary duplication and impose unnecessary costs on companies.

One option would be to **allow private companies the option of making their company registers of members publicly available at Companies House** instead of at their registered office. The company would be required to update the register held by Companies House in the same way that they are currently required to update the register that they hold. The company would remain wholly responsible and liable for the accuracy of the information on that register.

Currently, the information held by the company on its legal owners and that held by Companies House on the company's legal owners is not the same. Similarly, the access arrangements that apply in relation to the company's register of members are not the same as the arrangements that apply in respect of information made publicly available by Companies House. We will carefully consider the access arrangements that would apply in respect of the additional information that would be held by Companies House if this reform were taken forward.

We believe this option would only be practicable for companies with a small, stable shareholder base. For companies whose register of members changes frequently, the existing arrangements would continue to apply. This proposal will be considered in more detail in consultations to be issued in the autumn.

In advance of the formal consultation we welcome views and estimates on:

- The broad possible costs and benefits of a policy change to the registers of members?

2.65. If reform to allow companies to make their register of members available at Companies House were taken forward, we might suggest that the company should be able to hold and make available beneficial ownership information in the same way. We will therefore give further consideration to the beneficial ownership information that companies themselves might be required to hold in light of the outcome of these wider consultations.

We welcome views on:

- Whether beneficial ownership information held by the company should be made publicly available? How?
- Should any framework of exemptions in relation to information held by the registry also apply to information held by the company?

(6) The impact of reform

2.66. Throughout this Part of the paper we have posed a series of specific questions. More generally, we also welcome feedback on the costs and benefits of the various proposals. This will help us to develop a full Impact Assessment in due course.

2.67. Quantifiable evidence on the **benefits** of the changes proposed here is very limited. There might be cost savings to companies due to their increased powers to obtain ownership information. There might be additional savings if regulated entities are given access to the registry, meaning that the company does not need to respond to as many requests for information. There would also be cost savings to law enforcement and tax authorities by enabling them to have access to a single source of beneficial ownership data and having faster and more effective powers for gathering information from companies. Regulated entities would similarly save costs if given access to the Companies House data as well. There are an estimated 80,000 enterprises[37] which might fall into the regulated entities groupings.

2.68. Arguably more importantly on the benefits side would be the increased likelihood of successful prosecutions; more stolen assets being recovered; and the increased deterrent effect. Any impacts on increasing the perceived integrity of the UK corporate governance framework should have a positive effect on the amount of investment, as well as potentially improving the allocation across the economy of that investment. Again no quantification on these wider benefits is available.

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[37] Annual Business Survey 2009, ONS

2.69. Clearly, the level of benefits relies heavily on compliance levels and hence on enforcement or sanctions: however, the stronger these actions are, the higher the associated public sector costs.

2.70. In terms of the **costs** of the proposals, there is similarly limited information. Assuming a base case of companies reporting their beneficial owners to Companies House annually, one estimate of the costs to business[38] is a £24m one-off cost plus £2.3m ongoing costs. This assumes 2.7m private companies. The vast majority of these companies are assumed to have simple ownership structures and thus it is assumed that it would take a few minutes only to identify and notify Companies House of the ownership. However, 54,400 private companies have off-shore directors and this is used as a proxy for a complex shareholding structure where significant time (five hours) and effort are expected to be required to identify beneficial owners for the first time. Overall, we consider the above estimate is likely to be a lower bound for the costs for companies.

2.71. These estimates are highly sensitive to the assumptions around wage costs and time spent by companies. If the wage costs were to increase by a half (i.e. to £31 per hour – that earned by a financial manager[39] including overheads) the total cost would also increase by 50%. Similarly if it took longer to identify the beneficial owner through the ownership layers the first time or in subsequent years, or if even companies with simple ownership structures had more difficulty in obtaining this information, costs would rise. Chasing up and checking the information by the company might additionally be required. Furthermore significant familiarisation costs (including legal services) might be incurred.

2.72. Shareholding companies in the ownership chain would also incur costs when responding to the requests for information from the companies in which they have shareholdings. It is expected that the costs of providing their details are likely to be low per respondent (in many cases potentially just a quick administrative task).

2.73. Clearly there will also be costs in terms of the beneficial owners responding to requests from companies and also potentially proactively providing the information. The above report estimates that there might be 410,000[40] unregistered beneficial owners alone, with 125,000 changes each year in terms of their details, transfers of ownership or new beneficial owners[41]. There might also be some other individuals who will need to consider whether they are beneficial owners or not and hence might incur additional one-off costs. These costs might run into several £million.

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[38] 'Costs of beneficial ownership declaration', John Howell & Co Ltd for Global Witness, April 2013: http://www.globalwitness.org/sites/default/files/library/Cost%20of%20Beneficial%20Ownership%20Declaration%20Report.pdf

[39] Annual Survey of Hours and Earnings 2012, ONS

[40] This uses the number of companies and the average number of shareholders per company. It excludes the estimated number of companies that have family shareholdings. It then takes the remaining shareholdings and, based on expert opinion and anecdotal information, assumes that 7.5% of these are likely to be beneficial owners that are not on the company's share register.

[41] Based on 2011/12 Companies House data for the number of new companies and on 2000/01 Companies House and HMRC data on changing details and transfers.

2.74. If they were given access to the registry, regulated entities would incur additional costs if they were required to check and report any inconsistencies between their own data and that held on the register. This is likely to be highly variable from one year to the next but, depending on the detail of the obligation, the costs could be expected to be low.

2.75. Companies House has indicated that there would be additional one-off costs of some £300,000 to change their systems plus small on-going costs. Other costs around issuing guidance and publicising the changes would also be incurred but these would vary with, for example, the format, the content, the level of detail and follow-up questions.

2.76. **Enforcement** of the changes proposed here would be required. Costs associated with this are uncertain and would clearly rely on the degree of compliance. Some non-compliance would be picked up in the investigations of the SFO and SOCA etc, whereas other, more innocent, lapses would need to be picked up in other ways. Current compliance with annual returns and company accounts being sent to Companies House is very high – at 98% and 99% respectively: a similar level of compliance might be expected over time but not initially.

2.77. In addition to the above costs and benefits are potential **unintended consequences** from the change. These might include reduced levels of legitimate investment; the deterring of the take-up of directorships; and lower numbers of company incorporations in the UK due to the greater disclosure requirements and costs. There will also be disruption within companies and for shareholders as information is sought.

2.78. There are options discussed in the paper that impact on the benefits and costs of these proposals:

- Whether regulated entities are allowed to access information in the registry – if not regulated entities would continue to incur the same costs of requesting the information and companies would still need to reply direct, but the cost to the companies would be low as the information would already have been gathered. If they were given access, however, there might potentially be one less source of validation of information provided to the registry by the company.

- The frequency of reporting and the level of accuracy required would affect the costs to companies, beneficial owners and Companies House.

- The degree of guidance, publicity and enforcement would impact on the public sector costs.

We welcome views and estimates on:

- The costs and benefits of this policy change for companies, beneficial owners, regulated entities and other organisations.

In particular, we would welcome views on:

- The link between the proposals and crime reduction;
- The link between the proposals and the incentives to invest;
- The numbers of companies affected;
- The amount of time it would take to obtain, collate and report data on beneficial ownership – for both simple and more complex ownership structures;
- Costs to the regulated entities;
- The changes which regulated entities might make to their actions;
- The number of beneficial owners;
- The degree of publicity and guidance required;
- Likely compliance;
- Potential unintended consequences; and
- The varying impacts of the alternate options.

Abolition of bearer shares

Defining 'bearer shares'

3.1. When a company issues shares to an individual or entity, the name of that individual or entity will be entered into the company's register of members. The legal owner of the company's shares is determined by the name that appears on the register. The register of members is made publicly available. This ensures transparency of legal ownership of UK companies.

3.2. There is however a way in which legal owners can conceal their identity. A company may issue a share warrant which states that the bearer of the warrant is entitled to the shares specified in it. These share warrants are commonly referred to as **'bearer shares'.**

3.3. The legal ownership of a bearer share can be transferred from one person to another without the need to change ownership details on the issuing company's register of members. In short, whoever holds the share warrant is the owner and the law requires no further evidence of ownership. A company's register of members will simply indicate that the share is held in bearer form. The company will not know the identity of the holder unless the individual identifies themselves to claim a dividend. Even then, their identity will not be recorded on the register of members.

3.4. Analysis indicates that 2,400 companies have issued bearer shares, of which around 900 companies are still trading, the remainder being dormant or dissolved. From a total population of 2.5 million companies, this represents 0.05% of companies so the corresponding impact of reform, in terms of the costs and benefits outlined below, will be relatively small.

3.5. Of an initial sample of 81 companies with bearer shares, the proportion of bearer shares varied from 0.01% to 100% with the total number of bearer shares per company ranging from one share to five million. However, from this small sample 80% of companies were entirely owned by bearer shareholders.

3.6. This information does not allow us to identify how many shareholders own the bearer shares in each company. It would be feasible, for instance, for one shareholder to own five million shares in the same company.

The scope for misuse

3.7. Bearer shares could be used for legitimate purposes:

- If a company was involved in controversial activities, such as animal testing research, and the shareholders had concerns about harassment and physical harm should their identities be revealed.
- Where anonymity of share ownership could be desirable to maintain competitiveness in the market. For example, in merger and acquisition activity, companies looking to invest in competitors could retain their anonymity without the awareness of the target company.

3.8. However, this anonymity of legal ownership means that bearer shares are also open to misuse. The owners of the company may use bearer shares to conceal their identity from the authorities for the purpose of tax evasion or other criminal activity. Individuals could use illegally gained money to buy bearer shares to 'hide' evidence of their unlawful activities.

3.9. It is notable that some company service providers[42] offer to form UK bearer shares companies, listing the selling point as the ability of such companies to hide the true owners of the company. Even where the legal owners are not engaged in any criminal activity, it is clear that this lack of transparency is inconsistent with our aim to ensure full transparency about who owns and controls UK companies.

3.10. There are ways to identify the owners of bearer shares in UK companies. For example, the Secretary of State can use his statutory powers under section 442 of the Companies Act 1985 to investigate who owns bearer shares. If the investigation failed to establish who owned particular shares there are further powers that effectively freeze the shares - voiding any transfers, removing the voting rights and stopping payment of any dividends due. Nevertheless, even where the bearer shares in question are frozen, the identity of the individual may remain unknown, and this therefore fails to provide transparency.

The need for change

3.11. The Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum) and FATF have both identified bearer shares as hotspots in facilitating tax evasion and money laundering. The Global Forum specifically recommends that the UK: *"[…] should either take necessary measures to ensure that robust mechanisms are in place to identify the owners of bearer shares or eliminate such shares[43]".*

3.12. In addition, under the UK's Presidency this year, the G8 has recognised the need to take action on bearer shares to ensure full transparency of company ownership. The G8 Principles on preventing the misuse of companies state that: *"The misuse of financial instruments and of certain shareholding structures which may obstruct transparency, such as bearer shares […] should be prevented[44]".*

3.13. The UK is committed to meeting the Global Forum and FATF standards in full. There are a number of ways to meet the standards. These range from:

- **Custodian arrangements,** such as requiring bearer shares to be held through a bank;

[42] Company Service Providers carry out a range of services in relation to the formation and operation of a company. See 'What is a Trust or Company Service Provider', HMRC: http://www.hmrc.gov.uk/mlr/getstarted/register/tcsp.htm (July 2013)
[43] 'Peer Review Report of the United Kingdom', Global Forum, 2009: http://www.oecd.org/unitedkingdom/peerreviewreportoftheunitedkingdom-combinedphase1phase2.htm
[44] 'Common principles on misuse of companies and legal arrangements', June 2013: https://www.gov.uk/government/publications/common-principles-on-misuse-of-companies-and-legal-arrangements

- The issuing company to maintain a **registry of bearer shares,** and only permit transfers through one registered account holder to another; or

- **Full prohibition**, by law, of new bearer shares and making it an offence to continue to hold existing bearer shares.

3.14. **We think that the most effective solution might be to prohibit the issue of new bearer shares.** We do not think that the potential legitimate uses of bearer shares outweigh the advantages of entirely preventing the potential for misuse.

3.15. We also need to consider how to deal with existing bearer shares. Other countries, particularly OECD members[45], have eliminated existing bearer shares. A number of them have used a **transitional process where new bearer shares are prohibited and existing ones are phased out over a set period of time** to allow the owners to convert them into ordinary registered shares, held electronically or otherwise. We might similarly adopt this model in the UK.

3.16. We think it would be important for the set period for conversion to be long enough to enable bearer shareholders to convert their shares, given that many individuals may well be holding them for entirely legitimate reasons.

3.17. In terms of the impact of abolishing bearer shares, the main **benefits** would emerge from a reduction in the potential for illicit activities associated with bearer shares and the corresponding cost savings to law enforcement and tax authorities' investigations. Shareholders would also benefit from the additional transparency of ownership structures.

3.18. In terms of **costs**, there might be an intangible one-off cost for legitimate bearer shareholders, who wished to retain their anonymity but were no longer able to do so. We also envisage a cost to the companies required to convert each bearer share.

3.19. We will however also need to consider the **wider impacts** of the abolition of bearer shares, for example, quantify the potential negative impacts to the companies and shareholders. In particular, we would want to minimise the potential for disenfranchising holders of their shareholder rights, and might need to consider additional arrangements to protect the identities of vulnerable individuals. We would need to ensure that sufficient transitional and communication arrangements were made in the event of any changes.

3.20. We also think measures would need to be in place to deal with any **bearer shares that remained unconverted at the end of the conversion period**. One option would be to replicate provisions of Part 22 of the CA06. Under sections 801 and 802 of that Act, unidentified shares may be frozen by the court. The company may then apply to the court for those shares to be sold. The proceeds of the sale are paid into the court for the benefit of the owner of the shares. The owner may then

[45] For example, Belgium and France.

apply to the court to receive those proceeds – but would evidently need to identify themselves in order to do so. In this way we would ensure the transparency of company ownership without removing any person's right to their property.

We welcome views on:

- Prohibiting the issue of new bearer shares.
- Whether individuals should be given a set period of time to convert existing bearer shares to ordinary registered shares? How long?
- Whether there are additional or other measures that we might take?

We welcome views and estimates on:

- The costs and benefits of this policy change.

Nominee directors

Defining 'nominee directors'

4.1. Companies are required to register certain details on their directors at Companies House. This information is then made available publicly by Companies House[46]. Where a company is being used to facilitate criminal activity, the individuals who really control the way that the company is run will likely want to avoid making this information public. They may use 'nominee directors' to do this. Nominee directors are individuals who go on the public record as the director of the company to be, effectively, a 'straw man' or 'front man' for the company. The beneficial owner 'stands behind' the nominee and controls the way that the company is run.

4.2. UK law does not define or recognise nominee directors. In the eyes of the law, nominee directors are the same as any other director and owe the same duties to the company. These include the duty to promote the success of the company and to exercise reasonable care, skill and diligence[47]. This means that a nominee director can be sanctioned for breaching these duties.

4.3. However, the use of a nominee director does not mean that the beneficial owner can avoid all liability for the actions of the company. In the event that the company was investigated, the beneficial owner can be treated and sanctioned as if they were a director of the company. But this depends on the prosecution being able to identify the beneficial owner and prove the extent of their influence and control over the management of the company. In practice, the use of a nominee director can therefore prevent the beneficial owner from being linked to the actions of the company.

4.4. Because they are not separately classified, Companies House does not hold data on the number of nominee directors. However, it does hold data on the number of directorships that individuals hold. If we assume that individuals acting as the director of over 50 companies are almost certainly acting as nominee directors, 1,175 individuals are deemed to be nominee directors. This equates to 0.3% of all directorships. We estimate that 141,600 companies[48] have nominee directors on their boards; however, this is judged to be an upper estimate as there may be more than one nominee director per company.

The scope for misuse

4.5. There have been a number of recent reports from international and non-governmental organisations, such as the World Bank[49] and Global Witness[50] that have demonstrated the potential for misuse, highlighting the role that nominee

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[46] With some exemptions - for example, directors' residential addresses are protected from disclosure (see Chapter 8 of the Companies Act 2006, c. 46: http://www.legislation.gov.uk/ukpga/2006/46/part/10/chapter/8).
[47] 'General duties of directors', Sections 171 to 177, Companies Act 2006, c. 46: http://www.legislation.gov.uk/ukpga/2006/46/contents
[48] This is calculated by multiplying the number of individuals in each group by a mid-point for each of the groups with over 51 directorships.
[49] 'Puppet Masters: how the corrupt use legal structures to hide stolen assets and what to do about it', World Bank, 2011: http://star.worldbank.org/star/publication/puppet-masters
[50] 'Grave Secrecy', Global Witness, 2012: http://www.globalwitness.org/library/grave-secrecy

directors play in facilitating criminal activities such as tax evasion and money laundering.

4.6. There are entirely legitimate uses for nominee directors. The legal framework works well for those who are acting, for example, as directors of a subsidiary company on behalf of the parent company. These arrangements are part of normal business practice, and we do not wish to prohibit arrangements of this sort where the nominee director is genuinely taking part in the running of the business and fulfilling their responsibilities.

4.7. A problem arises however with 'serial nominees' - people who are prepared to be registered as the director of a company in exchange for payment. They may rent their name to more than a thousand companies. It is likely that in some cases the nominee will not even know who the beneficial owner of the company really is.

4.8. These nominee directors do not take any part in running the company, having surrendered any right to do so by signing a power of attorney or similar legal instrument which allows the beneficial owner to act on the nominee's behalf in terms of the management of the company. The nominee might also provide the beneficial owner with a signed, undated letter of resignation. This means that the beneficial owner could 'arrange' the nominee's resignation if the nominee did try to run the company in any way.

The need for change

4.9. In view of the legitimate commercial reasons for the use of nominee directors we do not think it appropriate to prohibit them entirely. However, we do think there is a strong case for increased transparency in this area. Most nominee services are advertised as providing an easy and cheap way of concealing corporate control. This is obviously incompatible with the model of increased transparency of company ownership.

4.10. FATF recommends that measures should to be taken to prevent the misuse of nominee directors, such as:

- Requiring nominee directors to disclose the identity of their nominator to the company and to any relevant registry; or
- Requiring nominee directors to be licensed, for their nominee status to be recorded in company registries, and for them to maintain and make available information identifying their nominator[51].

4.11. And, as with bearer shares, the G8 has also endorsed the need for action. The G8 Principles on preventing the misuse of companies state that: *"The misuse of financial instruments and of certain shareholding structures which may obstruct transparency, such as […] nominee directors, should be prevented[52]".*

[51] The FATF Recommendations, February 2012: http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf

[52] 'Common principles on misuse of companies and legal arrangements', June 2013: https://www.gov.uk/government/publications/common-principles-on-misuse-of-companies-and-legal-arrangements

4.12. As noted above, the law treats nominee directors in the same way as any other director and nominee directors are subject to the directors' duties outlined in the CA06. This means that if a company were to be investigated, the court might disqualify the nominee for abrogation of these duties. One option might therefore be to **communicate more widely that any individual appointed to the office of director and so registered at Companies House is subject to these directors' duties.** This might have a useful deterrent effect for those nominees who were unaware of this fact and would not otherwise have agreed to the nominee arrangement.

4.13. In addition – or alternatively - we might **require nominee directors who have divested themselves of the power to direct the company to disclose this fact and provide details of the beneficial owner on whose behalf they have been appointed to Companies House.** We think there would be a **strong case for making this information public.**

4.14. It might be an offence for a nominee to fail to disclose this information, or to provide false information. In addition, breaching the requirement might automatically result in the individual's disqualification as a director. This would prevent them from being able to provide nominee services for the period of their disqualification. The prospect of future lost revenue might help to incentivise compliance.

4.15. In some cases the nominee might not know the beneficial owner and therefore be unable to disclose this fact. Such individuals would automatically be in breach of the requirement and therefore liable to be disqualified. This seems proportionate given the scope for misuse and/or criminal activity in cases where the beneficial owner of the company is entirely unknown.

4.16. We might opt to go still further. We think there is a strong argument that a director who has legally agreed to play no part in the management of a company will always be in breach of their directors' duties, as set out in the CA06. We might therefore make it **a specific offence for any director to divest themselves of the power to direct a company**, for example by giving another individual the power to exercise the directorship on their behalf through the signing of a power of attorney or similar legal instrument. The sanction might include disqualification. We would need to consider exemptions where such a document was signed for legitimate commercial reasons, for example, to cover the temporary absence of a director.

4.17. There would be a number of **benefits** to enhanced transparency. For example, if nominee directors were legally required to identify themselves, the potential for misuse should be reduced. Also, although largely intangible, the added transparency would inform investor decisions on the control and hence potential direction/ethos of the company and thereby potentially reduce the cost of capital for the company. If there were no reported nominee directors in a company, investors could be certain that the directors in place were actively involved with the company and had a fuller understanding of its operations.

4.18. There would however also be **costs** arising from the proposed changes. Nominee directors can be legitimately used to protect the privacy of individuals involved in particular companies who wish to remain anonymous, for example to avoid media scrutiny. Nominee directors can also legitimately be used as a proxy director of a subsidiary on behalf of the parent company. Thus the proposed policy could lead to an intangible one-off cost in the form of lost privacy and changes to company oversight. It might also deter investment in companies which are deemed unacceptable to some investors due to their directors (even where those directors are entirely law-abiding).

4.19. There could also be a cost to companies with nominee directors if the information were to be provided to Companies House via the company. The high-end estimate of 141,600 companies with nominee directors represents around 5% of the population of UK companies. Assuming a wage of £11.50[53] per hour for a company secretary and an estimated 15 minutes to identify and report nominee directors, this amounts to an annual cost to business of £0.5 million. There may also be some one-off familiarisation costs for the relevant companies: these costs might be one hour of a legal professional's time at £22.73 per hour, totalling £3.7m.

4.20. Ultimately, we anticipate that increasing the level of transparency of these arrangements would substantially reduce the demand for this type of service as an aid to illicit activity by removing the principal attraction – secrecy. And enhanced transparency will further help us understand who really owns and controls UK companies.

We welcome views on:

- Whether we should more widely communicate the application of directors' statutory duties to all company directors and whether we should – alternatively or in addition – require nominee directors to disclose their nominee status and the name of the beneficial owner on whose behalf they have been appointed. Why? Why not? If yes, should that disclosure be made available on the public record?
- Whether we should make it an offence for a director to legally divest themselves of the power to run the company. Why? Why not?
- Whether there are additional or other measures that we might take?

We welcome views and estimates on:

- The costs and benefits of this policy change.

[53] The Annual Survey of Hours and Earnings (ASHE), ONS (2012). The calculation uses the median rather than the mean with a 15% uplift for non-wage labour costs was applied to the median wage.

Corporate directors

Defining 'corporate directors'

5.1. The CA06 requires that private companies have at least one director, and public companies at least two. However, company directors do not have to be individuals. This means that a company or any other entity having legal personality may be the director of another company. They are called **'corporate directors'**. Whilst the law requires companies to have at least one director who is a 'natural person' (i.e. an individual), all the other directors could be companies. In addition, there is nothing to prevent the natural person director from being a nominee director.

5.2. In the UK the use of corporate directors is comparatively rare - the current number of corporate directorships for active companies on the UK register is 46,500. However, this includes some duplication because some corporate directors may sit on more than one board. Once these duplicates are removed, we estimate that there are around 13,000 corporate directors. This is approximately 0.4% of the total of 2.9 million company directors. Analysis suggests 11,600 separate companies have corporate directors on their boards, representing less than 0.5% of all active UK companies.

The scope for misuse

5.3. There are legitimate commercial reasons for the use of corporate directors. For example, a corporate director might be used to allow a parent company to manage how a subsidiary (or a number of subsidiaries) is run. We know however that the corporate director structure is open to misuse. Corporate directorships can be used to conceal beneficial owners in a complex corporate structure and across multiple jurisdictions to facilitate illegal activity. The structure opens up the potential to exploit an information gap between shareholders and those who do business with the company, and directors, which is created by the concealment of corporate control behind a corporate structure.

5.4. In addition, we have identified a number of cases where dormant companies appear to be acting as corporate directors of UK companies. It is questionable how a dormant company could fulfil its statutory directors' duties. And it would likely be difficult to trace the beneficial owners of a dormant company.

5.5. When domestic and international law enforcement and tax authorities are investigating companies, the use of corporate directors can therefore make it difficult to identify and prove who the beneficial owners of the company are. For example:

- If the company acting as corporate director has become insolvent or has been wound up it can be difficult to obtain documents from it and trace its directors.

- The company may have used layers of corporate directorships spanning several different jurisdictions to create a very complex ownership structure (around 25% of corporate directors are companies incorporated outside the UK). UK authorities would be reliant on the assistance of overseas authorities to try and trace the beneficial owners of any overseas companies involved in the UK company's ownership structure.

The need for change

5.6. **As with nominee directors, we think there is a strong case for increased transparency of corporate directorships.** We think this is necessary to complete the package of measures we are taking to decrease the ability of individuals to hide who really owns and controls companies.

5.7. Given the comparative rarity of corporate directors in the UK, and the potential for misuse, we think **there is a strong case to simply prohibit their use.** Countries such as Switzerland, the Czech Republic, Jersey, and some US states, have achieved this by stipulating that only individuals can be company directors. This means that companies would no longer be able to register a corporate director at Companies House.

5.8. There would be a number of **benefits** from the prohibition of corporate directors. Firstly, it might reduce the financial support of criminal activities through money laundering. However, this is not easily quantifiable because not all corporate directors are linked with criminal activities and indeed only a portion of related criminal activity is identified. Secondly, there would be cost savings for law enforcement agencies as considerable resources are used to investigate companies with corporate directors across several jurisdictions[54]. Thirdly, although largely intangible, prohibiting corporate directors could increase the clarity of the information on company control and on its direction/ethos available to inform investor decisions and thereby potentially reduce the cost of capital for the company. Without corporate directors on company boards it reduces the potential for illegal activity to take place within the company, which could raise investor confidence.

5.9. There would however be some **costs** associated with the changes. Corporate directors can legitimately be used as a means for a parent company to manage a subsidiary. The proposed policy would result in a one-off cost for these companies, in the form of the lost directorship and the management information acquired from that directorship. Also there is the potential cost of replacing the director. However, as noted above, these are likely to be relatively small costs given that less than 0.5% of all UK companies would be affected.

5.10. We would need to consider further transitional arrangements in respect of existing corporate directors. We might, for example, give companies a set period of time to replace their corporate directors with natural person directors.

[54] 'Puppet Masters: how the corrupt use legal structures to hide stolen assets and what to do about it', World Bank, 2011: http://star.worldbank.org/star/publication/puppet-masters

We welcome views on:

- Whether we should prohibit UK companies from appointing corporate directors. Why? Why not?

- If yes, what transitional arrangements might be appropriate?

- Whether there are additional or other measures that we might take?

We welcome views and estimates on:

- The costs and benefits of this policy change.

Part B: Increasing trust in UK business

Introduction

6.1. Part A of this paper looked at ways to improve transparency of the ownership and control of UK companies. This will help to shine a light on those companies that do not play by the rules and is an essential element of good corporate governance, giving investors and others the tools to hold companies to account.

6.2. In parallel, businesses, investors, employees and consumers must have confidence that companies are acting fairly and that the directors of those that do not will be identified and sanctioned. Businesses and individuals who behave honestly and responsibly should not be placed at a disadvantage by those who do not. Having an effective and trusted system for identifying and dealing with poor business behaviour gives reassurance that we operate a level playing field, and creates an environment in which honest entrepreneurs are willing to invest in activities promoting growth and employment.

6.3. The last few years have clearly brought to the fore specific issues related to the governance of banks. In light of the crucial role that these institutions play, there need to be robust sanctions against their reckless management. The Parliamentary Commission on Banking Standards (PCBS) rightly highlighted specific flaws in the regulation of the banks and made some important recommendations. The Government has already accepted all of its principal recommendations in this area. This paper takes another step forward in implementing these, by asking whether bank directors' statutory duties need to be changed; or whether other changes would be more effective in changing bankers' behaviour for the better. Any changes to the Financial Reporting Council's Corporate Governance Code would be contingent on the outcome of these deliberations.

6.4. In addition to the regulation of particular sectors, we have a general system for dealing with company directors – across all sectors of the economy – who fail to comply with their legal duties as set out in the Companies Act 2006 (CA06). Our current procedures for disqualifying unfit company directors result in around 1,200 directors each year being banned from acting in the management of companies for up to 15 years. We also pursue those guilty of criminal behaviour related to the management of a company, with around 90 directors being prosecuted each year.

6.5. We recognise that although we need robust powers to deal with miscreants, we must also ensure that honest directors are not deterred from running companies and taking risks. Many companies fail for genuine reasons - failure, in itself, is not an indication of misconduct. Indeed, some company failure is an inevitable part of a healthy and well-functioning economy.

6.6. Nonetheless, there may be ways we can strengthen the system for tackling unacceptable conduct. Whilst the latest Insolvency Service survey suggested that around 65% of those questioned had confidence in the enforcement regime[55], its adequacy has been called into question as individuals apparently responsible for major corporate failures have seemingly gone unpunished. As a result, public trust in the system has been affected. To improve confidence, we need to explore ways of strengthening the sanctions against directors who do not fulfil their duties. In particular by:

- Considering how to **improve the regulation of directors in key sectors** – for example the banking sector – such as through changing directors' duties.
- **Allowing sectoral regulators to disqualify** directors in their sector.
- Exploring whether we should broaden the **factors that should be taken into account** when deciding whether disqualification is appropriate and for how long.
- Looking at **options for creditor redress** to give creditors more chance of being compensated for losses incurred as a result of the misconduct of directors.
- Asking whether we should offer **education to directors** who have been disqualified.
- Considering whether individuals subject to **overseas restrictions**, or **convicted of relevant offences in another country** should be disqualified from being a director of a UK company.

6.7. Part B of this paper considers these proposals in more detail and invites views. Throughout the paper we pose a series of specific questions. **More generally, we also welcome feedback on the costs and benefits of the various proposals.**

[55] 'Stakeholder Confidence Survey', Insolvency Service, 2012: http://www.bis.gov.uk/insolvency/About-us/our-performance-statistics/StakeholderConfidence

Improving confidence in the insolvency system

In addition to the above proposals, we are also taking steps to improve trust in the professionals who deal with businesses when they go insolvent. The issues we believe are of most concern to business and consumers are the use of **pre-pack administrations** and the **fees charged by insolvency practitioners** (IPs). We are taking action in these and other areas to improve confidence in the insolvency profession:

- **An independent review of IP fees** has been concluded by Emeritus Professor Kempson of the University of Bristol. It has found that information provided to creditors follows legal requirements but is not easy to understand. It can, for example, be unclear what work IPs are doing to earn fees in a case or what a final fee might be. Banks as major creditors have strong control over fees by organising their own reports and reviewing IP spend. Disparate unsecured creditors do not have such power and it is incredibly difficult to challenge fees. We are carefully considering the report's recommendations and will respond in the autumn. The report and our response will be available on www.bis.gov.uk/insolvency in due course.

- **An independent review of pre-pack administrations** was launched on 15th July 2013[56]. The terms of reference are available on www.bis.gov.uk/insolvency. The review is expected to assess the usefulness of the pre-pack procedure in the context of business rescue and to assess whether pre-packs cause detriment to any particular groups of creditors. A report is expected by spring 2014.

- To make it easier for a consumer or small business to make a complaint about an IP we have recently launched a **Complaints Gateway**, which will provide a single point for such complaints. Regulators have also agreed to introduce **common sanctions** against IPs when complaints are upheld.

- Finally, we are looking to **enhance the powers of the Insolvency Service as oversight regulator** for sanctioning regulators of the insolvency profession where regulatory failure has occurred.

[56] A pre-pack is where a sale of the business of the insolvent company is arranged shortly before it goes into administration and is executed immediately thereafter (often with little or no marketing on the open market). The terms of reference for the review are available at www.bis.gov.uk/insolvency.

The current regime

Corporate enforcement activities and the regulatory landscape

7.1. Corporate enforcement activities are primarily undertaken by The Insolvency Service (IS), an executive agency of the Department for Business, Innovation and Skills. Both insolvent companies and live companies can be investigated. In cases involving insolvent companies, the IS considers the behaviour of those running the company and, where misconduct is identified, assesses whether there is a case for taking action against these individuals. With live company investigations, the IS considers whether there are sufficient suspicions of serious misconduct to justify an enquiry and, ultimately, a decision as to whether the company should be wound up. Specific enforcement actions taken by the IS include:

- Disqualification proceedings to prevent those who have shown themselves to be unfit to manage a company from doing so, for a set period, in the future;
- Winding-up companies operating in a manner contrary to the public interest; and
- Where criminality is discovered, reporting these findings to the relevant prosecution authority.

7.2. The IS carries out its investigation and enforcement functions across the entire spectrum of corporate activity, regardless of sector. In addition to this, there are other regulatory and law enforcement agencies able to seek disqualification of take other enforcement action against an individual for misconduct, including:

- Regulatory bodies such as the Pensions Regulator and Office of Fair Trading;
- Bodies with combined regulatory and criminal enforcement powers such as the Financial Conduct Authority and Prudential Regulation Authority (which has powers enabling it to ban individuals from certain regulated activities, including banking) and Trading Standards officers; and
- Criminal investigation and prosecution authorities including BIS Criminal Enforcement, the Serious Organised Crime Agency, the Serious Fraud Office and police forces, all of whom can seek the disqualification of an individual convicted of an offence in connection with corporate activity.

7.3. The PCBS recently highlighted weaknesses in the regulation of individuals operating in the banking sector specifically. The Government committed to strengthening the expectations placed on individuals who have a senior role in banks and to improving the powers of regulators to sanction those who do not take their responsibilities seriously; and published its response to the PCBS report on 8th July 2013[57].

The disqualification regime

[57] 'The Government's Response to the Parliamentary Commission on Banking Standards', July 2013: https://www.gov.uk/government/publications/the-governments-response-to-the-parliamentary-commission-on-banking-standards

7.4. The Company Directors Disqualification Act 1986 (CDDA) provides for the disqualification of directors. This can occur either by court order or by a director offering, and the IS (acting on behalf of the Secretary of State) accepting an undertaking not to act in the management of a company for a specified number of years. Information instigating an investigation can come from complainants or, most commonly, from insolvency practitioners or official receivers involved in cases. The court may also make a disqualification order against an individual where it has convicted that person of a criminal offence related to the promotion, formation or management of a company.

7.5. The effect of a disqualification order or undertaking is that the individual is barred from acting in the management of a limited company, for a set period, whether by being appointed as a director or by giving instructions to those who have been appointed as directors. The period of disqualification can be for up to 15 years, depending on the seriousness of the misconduct. Breach of a disqualification order or a disqualification undertaking is a criminal offence.

7.6. In deciding whether or not a director is unfit, the court has to have regard to a statutory schedule of **'Matters Determining Unfitness'**[58]. The Secretary of State (or the IS acting on his behalf) is required to have regard to the same matters when deciding whether to accept an offer of an undertaking from a person not to act in the management of any company.

7.7. On average, some 100 directors are disqualified each month as a result of IS enquiries – some five directors every working day – and the average length of a disqualification is around six years. The majority of these disqualifications relate to corporate insolvencies. The economy benefits from the disqualification regime: analysis suggests that for every company director disqualified there is a potential saving to the economy of about £85,000[59] in terms of potential damage they would otherwise cause.

7.8. The table overleaf shows the number of disqualifications made from 2007 to 2013, and for what reasons.

[58] Schedule 1 to the Company Directors Disqualification Act 1986, c. 46: http://www.legislation.gov.uk/ukpga/1986/46/contents

[59] Based upon 2011-12 IS enforcement evaluation data. Calculated using methodology originally developed by the NAO in evaluating the disqualification regime and updated for the conduct of IS evaluation exercises. http://www.official-documents.gov.uk/document/hc9899/hc04/0424/0424.pdf

	2007-8	2008-9	2009-10	2010-11	2011-12	2012-13
Disqualifications following investigation by official receivers in compulsory liquidation cases	507	528	540	579	408	351
Disqualifications following the investigation of reports of misconduct by company directors from insolvency practitioners acting under appointments in insolvency	559	676	781	794	692	618
Disqualifications following the investigation of a live company where misconduct by its directors has been revealed	28	29	10	15	12	4
Disqualifications on conviction of a criminal offence	79	48	57	49	39	58
Total disqualifications	**1173**	**1281**	**1388**	**1437**	**1151**	**1031**

Clarifying the responsibilities of directors in key sectors

The need for change

8.1. Company law applies to all companies, economy-wide, that fall under the CA06. The directors' duties in section 172 of the CA06 apply to all directors of Companies Act companies. Paragraphs 7.4 to 7.7 above explained how directors can be disqualified for failure to comply with their duties.

8.2. In addition, companies that operate in regulated sectors have to abide by the laws and rules set out in sector-specific regimes. Some sectoral regulators already have the ability to ban individuals from working in their regulated sector. For instance, the Financial Conduct Authority (FCA) has the ability through its administrative regime to ban individuals from having a significant influence function in a financial institution, and to prohibit individuals from working in the sector. Bans are imposed subject to an appeal by way of a re-trial before the relevant tribunal.

8.3. With respect to the banking sector, the PCBS recommended that the Department for Business, Innovation and Skills (BIS) should consult on changing the duties of the directors of large banks[60] to prioritise the 'safety and soundness' of the firm first over the interests of shareholders. This recommendation aimed to ensure that bank directors are always clear about their primary responsibility to maintain bank stability.

8.4. The Government strongly agrees that bank directors must maintain an awareness of their responsibility to safeguard the security and stability of their firm. We accept the need for changes that will have a real impact on bankers' behaviour, for example by giving directors specific duties under the proposed Senior Persons Regime. The Government would encourage the Prudential Regulation Authority (PRA) to reflect this in the proposed Senior Persons Regime and the PRA's Principles for Business. In addition, changes to introduce criminal sanctions for recklessness in relation to the management of a bank will further sharpen bank directors' focus on their personal responsibilities and duties in respect of the firm.

Our objective

8.5. As highlighted by the PCBS, there is a case for considering whether further changes are needed to ensure that directors in the banking sector – and potentially in other key sectors – operate in the long-term interests of their firms. One option suggested by the PCBS is to amend directors' duties so that the primary duty of bank directors is to promote the 'safety and soundness' of the firm.

8.6. There are also ways it would be possible to **strengthen the enforcement of existing rules** to enhance their deterrent effect and protect the public from harm. This would mean that when directors do not meet the standards expected of them, this is taken into account in deciding whether to disqualify them and for how long. It

[60] Banks over the ring-fence threshold (in line with the recommendations of the Independent Commission on Banking)

is crucial that any changes should result in real behavioural change by directors whilst also strengthening the way these sectors work, in the long-term interests of companies and the economy. These options are explored below and in the following sections.

Changing directors' duties in key sectors

8.7. Company law is based on the understanding that members come together to form a company, and that the members may appoint directors to act on their behalf and run the company in a way which promotes its success and benefits the members as a result.

8.8. The CA06 codified certain common law and equitable duties of directors for the first time, making them clearer than before. The CA06 sets out seven general duties of directors, which include a duty to promote the success of the company for the benefit of its members or such other purposes as the company's constitution may specify (section 172). This duty codifies the current law and enshrines in statute what is commonly referred to as the principle of "enlightened shareholder value". The duty requires a director to act in the way he or she considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole and, in doing so, have regard to the factors listed.The decision as to what will promote the success of the company, and what constitutes such success, is one for the director's good faith judgment.

Companies Act 2006 Section 172 - Duty to promote the success of the company

(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—

- the likely consequences of any decision in the long-term,
- the interests of the company's employees,
- the need to foster the company's business relationships with suppliers, customers and others,
- the impact of the company's operations on the community and the environment,
- the desirability of the company maintaining a reputation for high standards of business conduct, and
- the need to act fairly as between members of the company.

(2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.

(3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.

8.9. The directors' duties operate cumulatively and at the same time: there is no hierarchy between them. The concern expressed by the PCBS was that in the banking sector, shareholder interest appeared to prevail over the other duties. Changing directors' duties for specific sectors – such as directors of large banks – could therefore have the merit of signalling clearly that the pursuit of shareholder value should not be at the expense of financial stability.

8.10. But it might also have drawbacks. The enforcement of directors' duties is entrusted to shareholders or (new) directors. Prior to the financial crisis most shareholders implicitly behaved as if their interests were aligned with banks' short-term interests. It is consequently not clear that such a change to the duties would be effectively enforced. As a result, it might not actually change bankers' behaviour for the better.

8.11. A further drawback is that not all banks operating in the UK are caught by the CA06 (either because they are not companies or not UK companies). Another is that it is not clear how shareholders would behave - for example, whether they would want to entrust funds with banks that explicitly see shareholder interests as subordinate to the stability of the firm.

8.12. More generally, the CA06 does not distinguish between sectors, only between size and types (e.g. quoted and unquoted) of companies. Doing so here would establish a precedent that could potentially be followed in future for other systemically important areas e.g. infrastructure companies. This would therefore call into question the general principle taken to date that sector-specific issues are best dealt with through a sector-specific regulatory regime, which operates in addition to a general company law regime.

8.13. The financial crisis has however shown that the current regime for enforcing existing directors' duties in the banking sector has had an insufficient deterrent effect, and thereby failed to protect the public from harm. The following sections of this paper therefore consider alternate options to strengthen the enforcement regime. These may be more effective in achieving the behavioural change sought by the PCBS. The following proposals would have implications for all systemically important areas in which company directors exercise their duties – not just the banking sector.

We welcome views on:

- The merits of strengthening responsibilities of banking directors by amending the directors' duties in the CA06 to create a primary duty to promote financial stability over the interests of shareholders. *This should be considered in the context of the banking regulation reforms the Government has already committed to and the further economy-wide measures set out in the rest of this paper.*

Allowing sectoral regulators to disqualify directors in their sector

The need for change

9.1. Some sectoral regulators already have the ability to ban individuals from working in their regulated sector. For example, the FCA has the ability through its administrative regime to ban individuals from carrying out a significant influence function in a financial institution, and to prohibit individuals from working in the sector. Bans are imposed subject to an appeal by way of a re-trial before the relevant tribunal.

9.2. However, sectoral regulators do not ban directors in their sectors for breaches of company law, but for sector-specific breaches. This means that a director in a regulated sector who is barred from having a significant influence function or is fully prohibited from working in that sector could still continue to operate as a director in other sectors of the economy. Yet it is arguable that directors who breach the responsibilities of a regulated sector may also have breached the general directors' duties established in the CA06 – and hence there is a question whether they should continue to be allowed to act as a director in any sector.

Our objective

9.3. The financial crisis has shown that some senior management individuals' behaviour in looking after the long-term interests of their company has been seriously deficient. We are therefore considering whether we need to do more to ensure that directors who are disqualified from holding senior posts in their sector for breaches of sector-specific rules are duly held to account in a larger field, by being disqualified, where relevant, from acting as directors of any CA06 company.

Strengthening sectoral regulation

9.4. We are interested in views on whether, in certain circumstances, **people found to have breached sectoral regulations and barred from acting in a certain sector should also be barred from holding any directorship** (irrespective of sector). In practice, this could be done by providing sectoral regulators such as the Pensions Regulator, FCA and PRA with additional powers to disqualify directors - either by taking court action or by accepting an undertaking from directors. This could be achieved by amending the CDDA.

We welcome views on:

- Whether, in certain circumstances, directors barred or prohibited from senior positions in key sectors should be considered for disqualification from acting as directors of any CA06 company?

- Which sectoral regulators should have the ability to make an application to the Court for a disqualification order, or to accept a disqualification undertaking from a director?

- The potential costs and benefits of this proposal.

Factors to be taken into account in disqualification proceedings

The need for change

10.1. When determining whether a director is unfit, the court must take account of matters set out in Schedule 1 to the CDDA. Although disqualification proceedings are civil proceedings, in which the court applies a civil standard, practice has shown that the court seeks a relatively high level of evidence to support allegations of unfitness to be a director. This reflects the fact that a disqualification order can have a major impact on the commercial freedoms of an individual. Case law has established that disqualification proceedings are not ordinary civil proceedings.

10.2. Notwithstanding this, some 80% of disqualifications are obtained by directors offering an undertaking not to act in the management of a company, and a relatively small proportion of cases are discontinued or lost at Court. In 2011-12, three disqualification cases were lost at court and 43 were discontinued after proceedings had been issued. Naturally, the Secretary of State only pursues cases where it is considered that there is a greater than 50% chance of obtaining a disqualification order and the high success rate of cases reflects this approach.

10.3. Many companies fail for genuine reasons. As we have noted, the mere fact that a company has been involved in a company that has failed does not on its own suggest that the director is unfit. However, the financial crisis has shown that the current regime for enforcing existing directors' duties (e.g. in the banking sector) has had an insufficient deterrent effect, and thereby failed to fully protect the public from harm. Given the serious punitive and financial effect disqualification has upon an individual, we believe that the actual standard of evidence required by the courts to determine misconduct is probably correctly calibrated and does not require any major alteration. However, the same may not be true of the factors that are required to be taken into account, by the court or Secretary of State, when determining whether to disqualify directors, and/or in determining the length of their disqualification - particularly given that there have been no substantive amendments to Schedule 1 to the CDDA since it came into force.

Our objectives

10.4. There are four areas where the matters to which the Court, or Secretary of State, should have regard could be extended:

- **Material breaches of sectoral regulation;**
- The **wider social impacts** of the failed company;
- **The nature of creditors** and the **degree of loss** they have suffered; and
- The director's **previous failures.**

10.5. In this paper we therefore consider whether the court should take account of the actions of a director who has materially breached specific sectoral regulations – such as a bank director who materially breaches financial services rules. We similarly consider whether any wider social impacts from the failure of a company should also be taken into account, to ensure that the totality of any impact from the catastrophic failures of individual firms can be duly reflected in the consequences felt by their directors. In addition, where a director's misconduct has resulted in losses to more vulnerable or less sophisticated creditors, we want to ensure that this fact is taken into account by the court when deciding whether a person should be disqualified and in setting the disqualification tariff. Finally, we want to consider whether an individual who has displayed a pattern of behaviour resulting in repeated company failure or creditor loss – whether due to incompetence or culpable behaviour - can be prevented from doing so again.

Regard for material breaches of sectoral regulation

10.6. Although not explicitly required by the law, the court and the Secretary of State tend to take a proportionate approach when considering whether to disqualify a person and for how long. However the law does not explicitly provide for the option of considering material breaches of relevant sectoral regulation when formulating their view. There is however a strong case for arguing that a material breach of sectoral regulations – such as in the banking sector – is incompatible with fulfilling directors' duties as set out under the CA06.

10.7. We are therefore interested in views on whether Schedule 1 to the CDDA should be amended to **explicitly allow the Secretary of State and the court the option of taking into account material breaches of relevant sectoral regulation**. This could be used to help determine whether directors should be disqualified or help determine the length of the disqualification period.

We welcome views on:

- Whether Schedule 1 to the CDDA should be amended to provide that any breach of sectoral regulations is a matter of unfitness that may be taken into account by the court in disqualification proceedings?

Taking into account wider social impacts

10.8. As noted above, although not explicitly required by the law, the court and the Secretary of State tend to take a proportionate approach when considering whether to disqualify a person and for how long; taking into account the scale of loss suffered by creditors resulting from the misconduct and any wider economic or social impact. Given the catastrophic failure of certain firms and the impact this has had on wider society over the last few years, there is a strong argument that the scale and social impact of misconduct should be more clearly and explicitly taken into account when determining whether to disqualify directors and/or the length of their disqualification period.

10.9. For these reasons, we are interested in views on whether Schedule 1 to the CDDA should be amended to **allow the Secretary of State and the court the option of taking into account any wider social impact of a director's actions**. This could be used in determining whether directors should be disqualified or the length of the disqualification period. We clearly need to consider how 'wider social impact' would be defined, and in particular whether some form of materiality test should be applied.

We welcome views on:

- Whether Schedule 1 to the CDDA should be amended to provide that 'wider social impact' is a matter of unfitness that may be taken into account by the court in disqualification proceedings?
- How 'wider social impact' should be defined and whether a materiality test should be applied?

Greater regard for those affected by a director's actions

10.10. Where a director has demonstrated prejudicial treatment to one creditor, or class of creditors, at the expense of others, this can be a basis for disqualification action. However, the law does not provide for the courts to treat vulnerable creditors differently to other creditors, or to have regard for any others who may have suffered loss indirectly as a result of a director's misconduct. Case law shows that the courts remain committed to the principle of equal treatment of creditors. There have however been strong calls in the wake of the Farepak failure – where customers had saved for Christmas hampers and had wrongly assumed that their savings were not at risk - for the category of losing creditors to be taken into account.

10.11. Schedule 1 to the CDDA already requires regard to be had to conduct which has resulted in any failure by the company to supply goods or services which have been paid for (in whole or in part). Therefore, to a certain extent, higher standards are expected of directors where goods or services have been prepaid, such as where consumers have paid deposits in advance for goods to be delivered or manufactured. In practice, however, it is questionable whether the courts treat such creditors differently to any other class of creditor and they have shown a reluctance to disqualify on the basis of an allegation of withholding customer deposits alone - particularly if the use of pre-payments or deposits is common practice in that industry.

10.12. There is an argument that, where vulnerable and unsophisticated consumers are involved, or where the business of the company involves the taking of a high volume of deposits or pre-payments, **directors ought to be more aware of the social impact of their actions and should pay more regard to the interests of such creditors** when the company encounters financial difficulties. Whether they pay this regard could be a relevant **factor to be taken into account by the court** when considering whether they should be allowed to continue as a director. Schedule 1 to the CDDA could be amended to require the courts to consider this.

10.13. An alternative would be to tailor the nature of any disqualification. For example, **a director could be disqualified from acting in the management of any company for one period and from acting in the management of any company dealing with high volume deposit or otherwise vulnerable creditors for a greater period.** This would mean, for example, that the director of a company which had been engaged in selling pre-paid gift cards who was found to be unfit could be disqualified for five years from acting in the management of any company, but ten years from acting in the management of any company whose business involved taking deposits or pre-payments from members of the public. This would require an amendment to the CDDA.

We welcome views on:

- Whether, where unfitness meriting disqualification has been found against a director of a company that dealt with high volume deposits or otherwise vulnerable creditors, two tariffs of disqualification should be handed down (or agreed by way of undertaking):
    - A tariff with respect to acting in the management of all companies; and
    - An increased tariff with respect to acting in the management of any company dealing with high volume deposits or otherwise vulnerable creditors (or a company engaged in a business similar to that in relation to which they had been disqualified)?
- Whether Schedule 1 to the CDDA should be amended to provide that failure to pay particular regard to the protection of deposits, pre-payments or otherwise vulnerable creditors once a company has become insolvent is a matter to be taken into account by the court when deciding whether a director is unfit and should be disqualified (or by the Secretary of State in deciding whether to accept a disqualification undertaking)?

Taking into account a director's previous failures

10.14. There is concern that our current regime can allow directors of failing companies to utilise insolvency processes to shed debts and start again - sometimes repeatedly - using much of the old business.

10.15. The mere fact that a director has been involved in a company that has failed does not on its own suggest that the director is unfit. Companies can fail for reasons outside of the director's control. And if failure itself is punished, there is a risk that this could deter productive risk-taking or business rescue so we need to approach this area with care. It must be shown that the director bears some responsibility for the causes of the insolvency, or is responsible for some other misconduct relating to it. Nonetheless, where there has been some degree of culpability in the past it is right that this should be taken into account within the disqualification proceedings.

10.16. Currently, any application for disqualification must be made in respect of a 'lead' company. Misconduct must then be sufficiently evidenced in that lead company for the application to succeed on its own. Where there is properly evidenced misconduct with respect to other ‘collateral companies’, this can also be taken into account. The court can also consider the director’s conduct in relation to foreign companies[61].

10.17. Current case law suggests that whilst courts are willing to consider previous failures, they will do so only where misconduct can be specifically evidenced in those companies as well as in the lead failure. As a result, where evidence of misconduct cannot be adduced in prior failures there is no value in the Secretary of State routinely citing the early failures when bringing disqualification proceedings, especially given that a pattern of unconnected company failures alone is an insufficient ground on which to bring disqualification action.

10.18. Whereas, in many cases, disqualification has been made on the basis of misconduct in the lead company and misconduct made out in previous failures, an analysis by the IS of allegations made in disqualification cases successfully brought in 2011-12 shows that in only two cases were specific allegations made of multiple failures.

10.19. However, the purpose of the CDDA is to protect the market from the unfit director, and unfitness can take the form of ‘honest incompetence’ just as much as culpable misconduct. It may be that a director has been involved in a series of company failures which, whilst not displaying culpable behaviour, do show a pattern which suggests that the market should be protected from their activities, for example:

- Trading with similar business models without learning lessons from previous failures.
- Where the same creditors or class of creditors, such as HMRC, appear disproportionately amongst the liabilities of each successive failure.
- Where there is a trend towards incomplete company records or tax returns.

10.20. To ensure that the market is offered appropriate protection from the activities of the ‘honest incompetent’ as well as from those of the clearly culpable, we propose that **Schedule 1 to the CDDA should be amended to ensure that the court can take greater account of previous failures.** This would mean that, where a director had been involved in a number of companies that had become insolvent, and there was misconduct with respect to the lead company, the court may decide that the person is unfit to continue to act in the management of any company. As is the case now, aspects of the director’s prior record that mitigate against that should also be capable of being taken into account by the Court, for example, where the director can provide evidence of companies that he or she has helped rescue in the past.

10.21. It has been suggested that there should be a **finite number of failures,** beyond which the presumption is made that a director is unfit and should be disqualified. Whilst this is worthy of consideration there is clearly a risk that it could deter

[61] Re Eurostem Maritime Ltd [1987] B.C.C. 190

entrepreneurialism and be a significant disincentive to good directors, preventing them from either remaining within a struggling company in order to turn it around or to joining a new company for the same purpose.

We welcome views on:

- What account the court (and the Secretary of State when deciding whether to take action) should take of the track record of the director (including the number of failures a director has been involved in) when deciding whether or not to disqualify an individual and for how long?

- Whether there should be a certain number of failures beyond which the presumption is that a director is unfit and should be disqualified. If so, what should that number be?

Improving financial redress for creditors

The need for change

11.1. A complaint frequently heard from creditors is that although disqualification can prevent a director acting as such in future, it provides no compensation to those who have suffered from their misconduct. The main purpose of the disqualification regime is to provide protection to the market and consumers from the acts of those directors whose conduct falls below expected standards. However, those who have suffered from that misconduct do not directly benefit from the disqualification action, and many remain sceptical about how effective disqualification is in tackling poor director behaviour.

11.2. Although insolvency law contains civil remedies that insolvency practitioners (e.g. liquidators and administrators) may use to seek financial redress against directors it is thought that these powers are used infrequently, largely because funds are not available to the insolvency practitioner to bring court actions. Often, cases are only taken forward on a conditional fee arrangement basis. This option may be less viable in insolvency cases after April 2015 when reforms to this type of funding arrangement are due to be implemented, leaving claimants unable to recover 'success fees' from defendants when claimants succeed in litigation[62].

11.3. The UK's approach to creditor redress contrasts markedly with other jurisdictions. In some countries, director misconduct is dealt with more often by allowing creditors and shareholders to litigate to recover losses. In the United States for example, relatively few directors are disqualified but creditors have rights to take recovery action themselves. In Australia, the courts can consider a civil pecuniary award (proceeds to the State – maximum award $200,000), and compensatory awards for creditors for loss suffered as a result of the actions of the directors and others. This is on top of actions to disqualify directors.

Our objectives

11.4. We need to find ways to increase trust in our regime by ensuring that if directors (and those advising them) act fraudulently or recklessly they personally run the risk of being required to compensate those suffering loss as a result; and to ensure that directors are aware of this. We want to:

- Increase the prospects of culpable directors being pursued where they have been responsible for allowing companies to trade wrongfully or fraudulently, by **allowing a liquidator to sell or assign a civil action to a third party**; and

- Explore new ways by which culpable directors may be called to account, by giving the courts powers to make **compensatory awards** at the time they make a disqualification order.

[62] Legal Aid, Sentencing and Punishment of Offenders Act 2012, c. 10: http://www.legislation.gov.uk/ukpga/2012/10/contents

Assigning wrongful and fraudulent trading actions

11.5. A liquidator can currently bring a civil claim for fraudulent or wrongful trading[63] against the directors of an insolvent company. A successful application by the liquidator can lead to the court requiring that the directors responsible make a personal contribution to the insolvent company's assets. However, the liquidator has no right to sell or assign the action in the way they can other assets of the insolvent company. This means that if the liquidator does not have the funds to pursue the claim, there will be no way of securing financial redress under these actions for the creditors.

11.6. This civil claim is not a sanction available to administrators. An administrator wishing to pursue this type of claim would first have to put the company into voluntary liquidation. That is an unnecessary cost and so we **propose to give administrators the right to take the action themselves.** The Government will be consulting on this very soon.

11.7. In this paper we are seeking views on a proposal that would give these provisions more bite by **granting liquidators the statutory right to sell or assign fraudulent and wrongful trading actions.** This would enable a liquidator to sell the claim on to an individual creditor, group of creditors, or possibly even a third party. Subject to the terms of the assignment, the purchaser could take all the risk and bear all the cost of pursuing the prospective claim, but would stand to gain fully from potential benefits arising from the action.

11.8. The right to pursue an action would constitute an asset of the insolvent company. Unpaid creditors of that company would therefore benefit, to the extent that proceeds from the assignment of an action increase the prospect of a dividend being paid. We anticipate that a market in these actions would develop, and increase the prospects of actions being taken against directors more frequently. Once directors realise that the threat of action is real, they may be more likely to offer to settle, and long-term changes to behaviour could potentially result.

11.9. There may be practical barriers which affect a purchaser's ability to pursue a claim. For example, the purchaser would not have the same access to information (such as the company's records) or the statutory right to make enquiries that a liquidator has. Nevertheless, we invite views on whether these reforms could create a more robust system for financial redress. There are examples of firms in the private sector that specialise in acquiring civil insolvency claims and who would have an interest in acquiring or advising in relation to this type of litigation.

11.10. If these reforms were pursued, safeguards might also be needed. One option would be to **prevent a prospective defendant, or any person connected to them, from acquiring the right to an action** for the sole purpose of extinguishing it. However, neither the liquidator nor the creditors are likely to know of all persons connected to the directors and such a protection might not therefore be effective. Another would be to **allow any party to acquire the action and leave it to the**

[63] Sections 213 and 214 of the Insolvency Act 1986, c. 45, respectively: http://www.legislation.gov.uk/ukpga/1986/45/contents

market. In that way if the prospective defendant is the only willing purchaser, the estate would at least benefit to the extent of what that director is willing to pay for it. This would need to be weighed against whether it would be appropriate to allow directors to effectively pay to avoid the risk of being ordered to pay greater compensation.

11.11. An alternative safeguard could be to state that if the acquiring party does not commence the action within 12 months, the **right of action reverts to the liquidator.** Whilst this might give the liquidator (if still in office) an opportunity to find an alternative purchaser, in practice there might not be a realistic prospect of a further sale of the action.

11.12. Some aspects of these proposals may fall within the powers devolved to Scotland for determining insolvency policy. When considering reforms we will work with the Scottish Government to determine whether similar reforms should be implemented in Scotland.

We welcome views on:

- How frequently the possibility of bringing wrongful and fraudulent trading claims arise, are pursued and what value the existing civil remedies for wrongful and fraudulent trading provide?
- Whether, if liquidators were able to sell or assign wrongful and fraudulent trading actions, more actions would be taken? If so, how many more?
- The extent to which creditors would benefit from this proposal?
- What practical difficulties might prevent third parties pursuing claims and how these might be overcome?
- Whether safeguards would need to be introduced to prevent certain parties acquiring such a claim? If so, who should they apply to and what form should they take?
- Whether this proposal would improve confidence in the insolvency regime?

Giving the court a power to make a compensatory award against a director

11.13. We want to explore whether **giving the court a power to make a compensatory award against a director** at the time it makes a disqualification order would improve confidence in the insolvency regime. The aim would be to increase the likelihood of culpable directors being called to account for their actions, whilst providing better recourse to funds for creditors who have suffered.

11.14. While disqualifications are currently brought by the Secretary of State in the public interest, civil remedies are brought and funded by creditors. Bringing together these two aspects could potentially entail a larger role (and cost) for the State in bringing civil actions. It could be possible for any compensatory award to be used to cover these costs before the remainder was passed to the liquidator for distribution. We would envisage that the compensatory award could not be used to cover the general expenses of liquidation - except in so far as they are costs directly attributable to the compensation claim. There is a question as to who should benefit from any compensatory award. This could be creditors generally or it could be left to the court to determine based on the facts of the case.

11.15. Liquidators would still be expected to consider whether there are any actions they could bring themselves, as they ought to now. Such amounts recovered by the liquidator form part of the assets of the company and are available for repaying the expenses of the liquidation before being applied to preferential and unsecured creditors in the due order of priority. If by the time the disqualification action comes before the court, liquidators have successfully recovered monies from the directors, that is something the court would be expected to take into account when deciding whether or not to make a compensatory award (or in setting the amount of it).

11.16. This measure could potentially affect the timeliness of obtaining disqualifications if it deterred directors from offering a disqualification undertaking and therefore resulted in more disqualification cases needing to be taken to court. On the other hand, it would provide a greater possibility of redress.

11.17. As above, some aspects of these proposals may fall within the powers devolved to Scotland for determining insolvency policy. When considering reforms we will work with the Scottish Government to determine whether similar reforms should be implemented in Scotland.

We welcome views on:

- The benefits of giving courts the power to make compensatory awards against directors?
- The potential costs and drawbacks of this proposal?
- Who should receive any monies recovered by action: should it be creditors generally or left to the court to determine?
- Whether the IS (acting on behalf of the Secretary of State) should be able to request and agree a compensation award from a director when it accepts an undertaking from the director not to act in the management of a company for a certain number of years?
- Whether this proposal would improve confidence in the insolvency regime?

Time limit for disqualification proceedings

The need for change

12.1. Under the current disqualification regime, disqualification proceedings in insolvent company cases are most commonly brought under section 6 of the CDDA. Section 6 provides for the disqualification of an individual who is or has been a director of a company which has at any time become insolvent (whether while he was a director or subsequently), and whose conduct as a director of that company (either taken alone or taken together with his conduct as a director of any other company or companies) makes him unfit to be concerned in the management of a company. These actions must usually be commenced within two years of the date of the first insolvency event unless the court orders otherwise.

12.2. In the vast majority of cases, such a time limit does not pose a barrier to addressing misconduct and the Secretary of State very rarely fails to bring proceedings purely because of this limitation period. However, the time limit might pose a barrier to disqualification action in a minority of cases where the information regarding unfit conduct does not come to light until a very late stage (in most cases officials acting on behalf of the Secretary of State are heavily reliant upon information and evidence being made available by a liquidator or administrator) or where the case is exceptionally large, complex or time consuming. Indeed it can quite easily be several months before the relevant insolvency practitioner reports to the Secretary of State detailing the areas of misconduct that may require investigation. In such cases, the limitation period might mean that misconduct is not addressed and an extension of time would be desirable.

12.3. There are several provisions other than section 6 under which disqualification proceedings may be taken, yet in none of those cases is there any statutory time limit. These include where in the course of a winding-up it appears a person has been guilty of fraud, or where it appears from investigative material available to the Secretary of State (such as a report made by inspectors appointed under the CA06) that a person is unfit.

Our objectives

12.4. We need to find a way to balance providing protection to the public and addressing the concerns of creditors with the need to ensure that any proceedings are brought reasonably promptly.

12.5. One option would be to **remove the time limit** under section 6 of the CDDA so that this is brought into line with other provisions in the Act. However, directors would then be left in perpetual uncertainty as to the possibility of action being taken against them. Instead, **we propose that the limitation period be increased to five years from the date of the first insolvency event.**

12.6. We would envisage that this extended period would only be required in a minority of cases and that the majority of proceedings would, as is currently the position, be instituted within two years of the insolvency event.

We welcome views on:

- Whether the period within which disqualification proceedings under section 6 of the CDDA must be instituted should be extended beyond two years?
- If yes, should that period be five years, some other period, or no limit at all?
- How many directors are likely to be affected?

Educating directors

The need for change

13.1. We strongly encourage enterprise, innovation and responsible risk taking in business. That is why, in accordance with a true enterprise culture, an individual who wishes to form or direct a company needs no formal qualification to do so. However, the court has found that: *"[…] directors have, both collectively and individually, a continuing duty to acquire and maintain a sufficient knowledge and understanding of the company's business to enable them properly to discharge their duties as directors*[64]*"*.

13.2. In cases of company failure, the lessons a director has learnt from being involved in the management of that company may equip them to have another go and make a success of a new business. Failures may also help to identify specific educational or training needs of directors which, if addressed, could prevent such failures happening again.

13.3. An analysis[65] of 2011-12 disqualifications obtained under section 6 of the CDDA show that the following allegations were made:

Type of Misconduct	Number of Allegations
Non payment of Crown Debts	635
Accounting matters	200
Transactions to the detriment of creditors	161
Criminal matters	102
Misappropriation of assets	56
Technical matters – statutory obligations	52
Trading at a time when the company is knowingly or unknowingly insolvent	7
Phoenix companies[66] or multiple failures	2

13.4. Many of the allegations in this list - and especially those most frequently arising - are matters that could be included within a training module or course. Crown debts, for instance, may build up because directors fail to complete statutory returns correctly (or at all) resulting in assessments being made by HM Revenue and

[64] Secretary of State for Trade and Industry v Baker (No 6), [1999] 1 BCLC 433
[65] Taken from the Insolvency Service's 2011-12 Annual Report: http://www.official-documents.gov.uk/document/hc1213/hc03/0358/0358.pdf
[66] Different successive incarnations of the same business

Customs (HMRC) for tax they believe to be due. A company's ability to challenge HMRC assessments will be impaired if the company has failed to keep proper accounting records. Educating a director about what basic records should be retained and how to turn that into management information could enable them to operate more successfully and responsibly in the future.

13.5. International comparisons suggest that other countries do more to promote 'bounce back' from failure. In some countries programmes have emerged where 'bounce back' support networks are offered to failed business people by trade groups and Chambers of Commerce that are active locally. This usually involves successful entrepreneurs giving support or advice to entrepreneurs who are faced with difficulties, or who are looking to restart after a failure. In France, for instance, a not-for-profit organisation created by entrepreneurs who had previously faced bankruptcy helps failed entrepreneurs set up a new business through mentoring.

Our objectives

13.6. We are not aware of any evidence that a director who has served their period of disqualification will return to the market better equipped to act in the management of a company than before. This suggests that the public interest may be better served by **offering disqualified directors the opportunity to undertake some form of education or training**, helping them to take positive steps to learn from previous mistakes.

13.7. We therefore propose that directors against whom disqualification action is to be taken could be offered the **opportunity of undertaking (at their own expense) some form of education or training which would result in a reduction of their disqualification tariff.** Building on this, we also propose that before making any application to act in the management of a specific company[67], a disqualified director must show that they have successfully undertaken approved education or training.

13.8. Training of this nature could be used to promote trust and confidence in the market by seeking to influence or address behaviours exhibited by unfit directors. This would be part of:

- Promoting fair competition and a level playing field for business;
- Promoting fair treatment of creditors and customers by businesses and individuals;
- Promoting the structures for viable and sustainable businesses;
- Promoting transparency of business ownership so that creditors and customers can make informed decisions; and
- Ensuring that the corporate and insolvency regimes are not abused, and that failure to comply with statutory obligations to the office holder or Secretary of State, or the breach of undertakings to the court, are addressed.

[67] Under section 17 of the CDDA, c. 46: http://www.legislation.gov.uk/ukpga/1986/46/contents

13.9. An offer to the unfit director to participate in some form of rehabilitative training activity could be made as part of the current process whereby the Secretary of State invites the director to offer a disqualification undertaking (which provides the director with an alternative to proceedings being issued at court). This could take the form of either a classroom course or online training module with an element of assessment. The expectation is that an organisation or body in the private or voluntary sector would be recognised by Government to provide the training.

We welcome views on:

- Whether, if some form of director education were to be introduced, it would increase trust in the enforcement regime?
- What form the training should take and who should provide it?
- What would be the likely cost of such training?
- Whether successfully completing any such training should enable a reduced period of disqualification; or should be a pre-condition for any disqualified director wishing to seek leave of the court to run a company whilst disqualified?
- Whether there would be value in offering such training to all directors of failed companies – irrespective of whether they were disqualified - having regard to the fact that the director would need to cover the cost?

Extending overseas restrictions

The need for change

14.1. A person who is disqualified or restricted from acting in the management of a company overseas; or who has been convicted of a criminal offence in connection with the management of a company overseas is not currently prevented from being the director of a UK company.

14.2. Although relatively few countries disqualify directors (and even where they do, this is not in great numbers), it does leave open the possibility of persons judged unfit in other jurisdictions being able to operate here, without even needing to notify the Registrar of Companies of restrictions that may apply to them elsewhere. Similarly, a person who has been convicted of a relatively serious criminal offence in connection with the management of a company overseas has no obligation to report that fact to the Registrar to enable it to be placed on the public record.

Our objectives

14.3. We want the business community, consumers and investors to trust our corporate regime and have confidence that individuals who have been found unfit to manage companies overseas are not able to set up and run companies here. At the very least, we think those dealing with limited companies ought to be able to check that officers of companies with whom they deal are not subject to restrictions that would prevent them from running companies elsewhere.

Recognising overseas disqualifications

14.4. Part 40 of the CA06 already contains powers to enable the Secretary of State to make regulations that would prevent a person who is subject to foreign restrictions from being a director (or otherwise being involved in the promotion, formation or management) of a company in the UK. **We propose to exercise this power to make regulations.**

14.5. These regulations could provide for a foreign restriction to apply in the UK automatically or, alternatively, only after an application has been made to a court here for a finding of unfitness. It would also be possible to make different provisions in different cases having regard, for instance, to the nature of the foreign restriction, the conduct in question and the country where the restrictions were imposed.

14.6. Some other overseas countries, including Ireland, already impose restrictions on directors who are disqualified elsewhere from acting as company directors in their jurisdictions.

We welcome views on:

- Whether regulations should be made using the powers in Part 40 of the CA06 to prevent persons who are subject to foreign restrictions (which fetter their freedoms to act in connection with the affairs of a company) being able to be directors or act in the management of companies in the UK?
- If yes, should the foreign restrictions be made to apply automatically in the UK, or should they require the Secretary of State to make an application to a court?
- If not, should a person subject to foreign restrictions be obliged to notify the Registrar of Companies if they act in the promotion, formation or management of a company in the UK?

Allowing courts in the UK to disqualify persons convicted overseas

14.7. We also **propose to amend the CDDA to enable the Secretary of State to bring disqualification proceedings against any individual who has been convicted of a criminal offence in connection with the management of a company overseas** if it would appear to be in the public interest to do so.

14.8. There might be practical difficulties in collating evidence if courts in the UK were to require sight of all of the evidence that was put before the foreign court to secure the criminal conviction. It would always be open to the court to request additional particulars, but it is anticipated our courts may be willing to place some reliance on the judgments of courts in other jurisdictions and make disqualification orders on the basis of more limited information about the conviction itself.

We welcome views on:

- Whether the Secretary of State should have the power to bring disqualification proceedings against a person on the sole basis that that person has been convicted of a criminal offence overseas in connection with management of a company or business overseas?

Overview of questions

We welcome views on:

Part A

- **Beneficial ownership and a central registry**

1. The proposed definition of beneficial ownership and its application in respect of information to be held by a central registry?

2. The types of company and legal entity that should be in scope of the registry?

3. Whether there should be exemptions for certain types of company? If so, which?

4. Extending Part 22 of the Companies Act 2006 to all companies as an aide to beneficial ownership identification by the company?

5. Placing a requirement on the company to identify the beneficial ownership of blocks of shares representing more than 25% of the voting rights or shares in the company; or which would give the beneficial owner equivalent control over the company in any other way?

6. Placing a requirement on beneficial owners to disclose their beneficial ownership of the company to the company?

7. Whether there are additional or other requirements we could apply to ensure that information on all companies' beneficial ownership is obtained? If so, what?

8. Requiring the trustee(s) of express trusts to be disclosed as the beneficial owner of a company?

9. Whether it would be appropriate for the beneficiary or beneficiaries of the trust to be disclosed as the beneficial owner as well? Under what circumstances?

10. Extending the investigative powers in the Companies Act 1985 to specified law enforcement and tax authorities?

11. Using the requirements that apply in respect of a company's legal owners as the model for beneficial ownership information to be provided to the company and the registry?

12. If not, what additional or other information we might require? How?

13. Whether there is a need to introduce additional or other measures to ensure the accuracy of the beneficial ownership information that is filed with Companies House and retained on the register?

14. If so, what? To what extent would the benefits of these measures outweigh the costs and other impacts?

15. Whether companies should be required to update beneficial ownership information at fixed intervals or as the information changes?

16. Whether beneficial owners should be required to disclose changes in beneficial ownership information proactively to the company?

17. The appropriate timeframes for notification of changes to the company or Companies House?

18. The broad possible costs and benefits of a policy change to the annual return.

19. Whether information in the registry should be made available publicly. Why? Why not?

20. If not, whether the information should be accessible to regulated entities? Why? Why not?

21. Whether a framework of exemptions should be put in place? If yes, which categories of beneficial owners might be included? How might this framework operate?

22. The broad possible costs and benefits of a policy change to the registers of members?

23. Whether beneficial ownership information held by the company should be made publicly available? How?

24. Should any framework of exemptions in relation to information held by the registry also apply to information held by the company?

25. The costs and benefits of this policy change for companies, beneficial owners, regulated entities and other organisations.

26. In particular:

    - The link between the proposals and crime reduction
    - The link between the proposals and the incentives to invest
    - The numbers of companies affected
    - The amount of time it would take to obtain, collate and report data on beneficial ownership – for both simple and more complex ownership structures
    - Costs to the regulated entities
    - The changes which regulated entities might make to their actions
    - The number of beneficial owners
    - The degree of publicity and guidance required

- Likely compliance

- Potential unintended consequences

- The varying impacts of the alternate options.

  - **Bearer shares**

27. Prohibiting the issue of new bearer shares.

28. Whether individuals should be given a set period of time to convert existing bearer shares to ordinary registered shares? How long?

29. Whether there are additional or other measures that we might take?

30. The costs and benefits of this policy change.

  - **Nominee directors**

31. Whether we should more widely communicate the application of directors' statutory duties to all company directors and whether we should – alternatively or in addition – require nominee directors to disclose their nominee status and the name of the beneficial owner on whose behalf they have been appointed? Why? Why not? If yes, should that disclosure be made available on the public record?

32. Whether we should make it an offence for a director to legally divest themselves of the power to run the company. Why? Why not?

33. Whether there are additional or other measures that we might take?

34. The costs and benefits of this policy change.

  - **Corporate directors**

35. Whether we should prohibit UK companies from appointing corporate directors. Why? Why not?

36. If yes, what transitional arrangements might be appropriate?

37. Whether there are additional or other measures that we might take?

38. The costs and benefits of this policy change.

Part B

- **Clarifying the responsibilities of directors**

39. The merits of strengthening responsibilities of banking directors by amending the directors' duties in the CA06 to create a primary duty to promote financial stability over the interests of shareholders. *This should be considered in the context of the banking regulation reforms the Government has already committed to and the further economy-wide measures set out in the rest of this paper.*

- **Allowing sectoral regulators to disqualify**

40. Whether, in certain circumstances, directors barred or prohibited from senior positions in key sectors should be considered for disqualification from acting as directors of any CA06 company?

41. Which sectoral regulators should have the ability to make an application to the Court for a disqualification order, or to accept a disqualification undertaking from a director?

42. The potential costs and benefits of this proposal.

- **Factors to be taken into account**

43. Whether Schedule 1 to the CDDA should be amended to provide that any breach of sectoral regulations is a matter of unfitness that may be taken into account by the court in disqualification proceedings?

44. Whether Schedule 1 to the CDDA should be amended to provide that 'wider social impact' is a matter to be taken into account by the courts in disqualification proceedings?

45. How wider social impact should be defined and whether a materiality test should be applied?

46. Whether, where unfitness meriting disqualification has been found against a director of a company that dealt with high volume deposits or otherwise vulnerable creditors, two tariffs of disqualification should be handed down (or agreed by way of undertaking):

    - A tariff with respect to acting in the management of all companies; and

    - An increased tariff with respect to acting in the management of any company dealing with high volume deposits or otherwise vulnerable creditors (or a company engaged in a business similar to that in relation to which he had been disqualified).

47. Whether Schedule 1 to the CDDA should be amended to provide that failure to pay particular regard to the protection of deposits, pre-payments or otherwise vulnerable creditors once a company has become insolvent is a matter to be taken into account by the court when deciding whether a director is unfit and should be disqualified (or by the Secretary of State in deciding whether to accept a disqualification undertaking)?

48. What account the court (and the Secretary of State when deciding whether to take action) should take of the track record of the director (including the number of failures a director has been involved in) when deciding whether or not to disqualify an individual and for how long?

49. Whether there should be a certain number of failures beyond which the presumption is that a director is unfit and should be disqualified. If so, what should that number be?

- **Improving financial redress**

50. How frequently the possibility of bringing wrongful and fraudulent trading claims arise, are pursued and what value the existing civil remedies for wrongful and fraudulent trading provide?

51. Whether, if liquidators were able to sell or assign wrongful and fraudulent trading actions, more actions would be taken? If so, how many more?

52. To what extent creditors would benefit from this proposal?

53. What practical difficulties might prevent third parties pursuing claims and how these might be overcome?

54. Whether safeguards would need to be introduced to prevent certain parties acquiring such a claim? If so, who should they apply to and what form they should take?

55. Whether this proposal would improve confidence in the insolvency regime?

56. The benefits of giving courts the power to make compensatory awards against directors?

57. The potential costs and drawbacks of this proposal?

58. Who should receive any monies recovered by action: should it be creditors generally or left to the court to determine?

59. Whether the IS (acting on behalf of the Secretary of State) should be able to request and agree a compensation award from a director when it accepts an undertaking from the director not to act in the management of a company for a certain number of years?

60. Whether this proposal would improve confidence in the insolvency regime?

- **Time limit**

61. Whether the period within which disqualification proceedings under section 6 of the CDDA must be instituted should be extended beyond two years?

62. If yes, should that period be five years, some other period, or no limit at all?

63. How many directors are likely to be affected?

- **Educating directors**

64. Whether, if some form of director education were to be introduced, it would increase trust in the enforcement regime?

65. What form the training should take and who should provide it?

66. What would be the likely cost of such training?

67. Whether successfully completing any such training should enable a reduced period of disqualification; or should be a pre-condition for any disqualified director wishing to seek leave of the court to run a company whilst disqualified?

68. Whether there would be value in offering such training to all directors of failed companies – irrespective of whether they were disqualified - having regard to the fact that the director would need to cover the cost?

- **Overseas restrictions**

69. Whether regulations should be made using the powers in Part 40 of the CA06 to prevent persons who are subject to foreign restrictions (which fetter their freedoms to act in connection with the affairs of a company) being able to be directors or act in the management of companies in the UK?

70. If yes, should the foreign restrictions be made to apply automatically in the UK, or should they require the Secretary of State to make an application to a court?

71. If not, should a person subject to foreign restrictions be obliged to notify the Registrar of Companies if they act in the promotion, formation or management of a company in the UK?

72. Whether the Secretary of State should have the power to bring disqualification proceedings against a person on the sole basis that that person has been convicted of a criminal offence overseas in connection with management of a company or business overseas?

How to respond

Submissions of evidence should be emailed to **transparencyandtrust@bis.gsi.gov.uk** clearly marked as a response to the *'Transparency and Trust discussion paper'*. Evidence will be reviewed thereafter. If further information or clarification is required, we will make contact as appropriate.

We are therefore inviting submissions and evidence by **Monday 16th September 2013** to inform our consideration of proposals to enhance corporate transparency and increase trust in UK business.

When responding, please state whether you are responding as an individual or representing the views of an organisation. If you are responding on behalf of an organisation, where applicable, please make it clear who the organisation represents and how the views of members were assembled.

In exceptional circumstances we will accept submissions in hard copy. If you need to submit a hard copy, please provide two copies to the Corporate Governance team at the following address:

Transparency and Trust
Spur 1, 3rd floor
Corporate Governance Team
Business Environment Directorate
1 Victoria Street
London
SW1H 0ET

We regret that we are not able to receive faxed documents.

Confidentiality & Data Protection

Information provided in response to this consultation, including personal information, may be subject to publication or release to other parties or to disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA) and the Data Protection Act 1998 (DPA). If you want information, including personal data that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.

In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.

Help with queries

If you have any questions about the policy issues raised in this document, please use the contact details above.

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Any enquiries regarding this publication should be sent to:

Department for Business, Innovation and Skills
1 Victoria Street
London SW1H 0ET
Tel: 020 7215 5000

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BIS/13/959