Department for Business, Innovation & Skills

Consultation stage Impact Assessments to Part A of the Transparency and Trust proposals (December 2013)

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Introduction - Transparency and Trust:

Explanation of the status of the policies outlined in the Consultation Stage Impact Assessments compared to the Government Response

Background

1. Since the Consultation Stage Impact Assessments (IAs) covering a central registry of company beneficial ownership information, opaque arrangements involving company directors and the prohibition of bearer shares were submitted to the Regulatory Policy Committee in December 2013, further consultation has taken place with both internal and external stakeholders.

2. These discussions have led to further refinement and development of the proposals. This latest position is set out in the accompanying *Transparency and Trust* government response document. **However, the IAs below reflect the policy options as at December 2013**.

3. Here we set out any differences between the previous and current preferred policy options, where applicable, and the next steps that we will take in respect of preparing the Final Stage Impact Assessments, which will be published in due course.

The central registry of company beneficial ownership information

4. The assessment of costs and benefits in the Consultation Stage IA is primarily based on the policy model outlined in the July Transparency and Trust discussion paper. Sensitivity Analysis in that IA sets out the key variables under consideration.

5. The Final Stage IA will reflect the final policy as outlined in the Government Response to the Transparency and Trust paper and will be published in due course. The principle changes between the Consultation and Final Stage IA are outlined below:

   - The **scope** of the proposals will be clarified. The Consultation Stage IA noted our intention to include UK incorporated companies and Limited Liability Partnerships (LLPs), with exemptions for companies listed on a regulated market. The Final Stage IA will clarify that UK bodies corporate that currently register information on their members at Companies House will be in scope (this will include companies and LLPs); and that companies complying with relevant provisions of the Financial Conduct Authority Disclosure and Transparency Rules (DTRs), and companies who have securities listed on a regulated market subject to equivalent disclosure requirements will be exempt. The Consultation Stage IA also considered exempting wholly owned subsidiaries of listed companies. The Final Stage IA will reflect that a company (A) owned by another company (B) need not provide beneficial ownership information about B provided B is exempt (e.g. because it is a listed company) or is a UK company and therefore already maintains a register of its beneficial owners.

   - The **information to be held** by the company and provided to Companies House will be expanded. The Consultation Stage IA analysis was based on reflecting the information held on company shareholders (name, address and details of interest in the company), but considered the holding of more information. The Final Stage IA will reflect that companies will be required to hold information on their beneficial owners' full name, date of birth, nationality, country or state of usual residence, a service and a residential address and details of their interest in the company. The Final Stage IA will also reflect which of these data fields will be made available publicly.

6. The assessment of the costs and benefits has further influenced policy thinking over the past three months. For example, the increased range of information companies would be required to obtain and provide to Companies House is considered unlikely to have a significant increase in costs but the benefits might be significantly higher if law enforcement agencies and others are better and more quickly able to uniquely identify the individuals recorded as the beneficial owner. Also the reduction in the number of companies in scope of the regulation, as a result of our intention to exclude companies listed on markets such as AIM, would reduce the costs at little or no reduction in the company ownership information available. Finally the method of information collection, whereby some companies need only identify one layer of ownership (i.e. simply stating that the company owning the shares is exempt or already holding a register of beneficial ownership information), is also expected to reduce the complexity and hence the costs companies face at little or no detriment to transparency.

Opaque Arrangements Involving Company Directors

7. In the government response document, we set out our intention to limit the use of opaque arrangements involving company directors, including corporate directors and individual directors acting irresponsibly as a 'front'.

8. The assessment of costs and benefits in the Consultation Stage IA is based on proposals developed from the Transparency and Trust discussion paper covering **corporate directors**. The assessment reflects the position as set out in the Transparency and Trust government response document – that we prohibit corporate directors with some exemptions. The exemptions described in the Consultation Stage IA are illustrative only, and as we develop thinking around the nature and scope of the exemptions we will conduct and publish further analysis.

9. The Transparency and Trust government response also sets out our intention to counter **opaque arrangements involving individual company directors**. It explains how the policy has in some aspects developed quite significantly from the original propositions in the Transparency and Trust discussion paper (in part because of internal cost benefit analysis). Where we are developing such proposals, we are conducting further analysis which we will publish in due course.

10. The costs and benefits of the measures which relate to the appointment of directors and informing them of their general statutory duties are set out in a separate IA covering Company Filing Requirements (published in parallel to this). That IA considers broader reforms to the appointment of directors.

Prohibition of Bearer Shares

11. The Consultation Stage IA covering bearer shares broadly represents the policy position set out in the government response document. The principle difference is around the timeframe and requirements in place for the period for converting bearer shares to registered shares. The government response sets out our policy position in a greater level of detail. The Final

Stage IA will contain a more detailed analysis of the costs and benefits associated with this more detailed position.

Final Stage Impact Assessments

12. The Final Stage IAs will set out the benefits and costs of the revised policy as set out in the Government Response. To validate and enrich the estimates of the impacts included in the Consultation Stage IA, we conducted additional research in the form of a further review of alternative sources of data, a further company survey commissioned by BIS and the views of additional focus groups. We have also revisited the results of the initial representative company survey to consider the implications for the final cost estimates of different statistical processing methods. The conclusions drawn from the additional research will be included in the Final IAs. We will publish these in due course.

Title: Transparency & Trust – Enhanced Transparency of Company Beneficial Ownership **IA No:** RPC13-BIS-1990 **Lead department or agency:** Department for Business, Innovation & Skills **Other departments or agencies:** Companies House, HMT, HMRC, Cabinet Office, MoJ, Home Office, SFO, NCA, CPS, Attorney General's Office, DFID, FCO	**Impact Assessment (IA)** **Date:** 16 April 2014 **Stage:** Consultation Stage **Source of intervention:** International **Type of measure:** Primary legislation **Contact for enquiries:** Transparency and Trust Team Tel: 0207 215 6178 Email: Transparencyandtrust@bis.gsi.gov.uk
Summary: Intervention and Options	**RPC Opinion: AMBER**

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, Two-Out?**	**Measure qualifies as**
-£899m	-£897m	£86m	No	NA

What is the problem under consideration? Why is government intervention necessary?

Opacity of the control of corporate structures can firstly facilitate illicit activity, and secondly lead to a deficiency in corporate governance which erodes trust and damages the business environment. Both can ultimately hold back economic growth. Government intervention is necessary to correct the regulatory failure underpinning the first, and the information asymmetry reflected in the second. A lack of knowledge around the beneficial ownership of UK companies – i.e. around the individuals who really own and control the company – can contribute to corporate opacity. The central problem under consideration is therefore the scope for misuse and poor corporate behaviour as a result.

What are the policy objectives and the intended effects?

The policy objective is to enhance the transparency of UK company beneficial ownership. The chosen option should implement the UK's G8 commitments and meet international standards on tackling the misuse of companies. We intend that enhanced transparency will deter illicit activity and improve enforcement outcomes where misuse does take place; and promote good corporate behaviour. We intend to implement a system that is both proportionate and effective.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

This Impact Assessment considers three options:
0) Firstly, we consider the 'Do Nothing' option and conclude that this would not meet the policy objectives.
1) We then consider the implementation of a **central registry of company beneficial ownership**. Although this has higher costs to business and individuals than Option 2, this is our preferred option as it would best meet our policy objectives, and UK G8 commitments – particularly in terms of delivering benefits to enforcement agencies and wider society through tackling illicit activity.
2) Finally, we consider a Government-led campaign to promote the importance of corporate transparency (non-regulatory option). Although costs would be lower than Option 1, this is our least preferred option as it would not deliver benefits in terms of tackling company misuse nor meet the UK's international commitments.

Will the policy be reviewed? It will be reviewed, pending determination of appropriate timeframes with respect to passage of primary legislation (e.g. within five years of coming into force).

Does implementation go beyond minimum EU requirements?			N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** Yes	**< 20** Yes	**Small** Yes	**Medium** Yes	**Large** Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** N/A	**Non-traded:** N/A	

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed by the responsible Minister: Jenny Willott Date: 5 March 2014

Summary: Analysis & Evidence Policy Option 1

Description: A publicly accessible central registry of company beneficial ownership information: Preferred Option

FULL ECONOMIC ASSESSMENT

Price Base Year 2013	PV Base Year 2013	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -1,078	**High:** -719	**Best Estimate:** -899

COSTS (£m)	Total (Constant Price)	Transition Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	181.2	1	62.5	**719.3**
High	272.8		93.7	**1,078.0**
Best Estimate	226.5		78.1	**898.7**

Description and scale of key monetised costs by 'main affected groups'

Costs to Government are estimated to be **£51-110k** for the IT development of the registry and communication to industry; and **£220k** pa on-going for the maintenance. Costs to businesses are estimated to be **£226m** set up cost (familiarisation, identification, collection, collation and storage of data), and **£78m** pa on-going costs for updating information and providing returns to Companies House.

Other key non-monetised costs by 'main affected groups'

It is also expected that the proposal will have costs to individuals, having to report their beneficial ownership status to companies in which they have a significant beneficial interest, and update this information as it changes. These costs have not been monetised as it is unknown how many individuals will have to provide the information.

BENEFITS (£m)	Total (Constant Price)	Transition Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	Unknown		Unknown	**Unknown**
High	Unknown		Unknown	**Unknown**
Best Estimate	Unknown		Unknown	**Unknown**

Description and scale of key monetised benefits by 'main affected groups'

Other key non-monetised benefits by 'main affected groups'

There is little quantified data about the benefits from this policy proposal. Benefits will be associated with (1) reduction in crime including increased efficiency by law enforcement agencies; reduced due diligence costs for regulated entities; and reduced criminal activity and, from this, efficiency and welfare gains to the economy (reduction in fraud crimes which are estimated at **£523m** pa); and (2) increased transparency which could potentially have an impact on economic growth.

Key assumptions/sensitivities/risks **Discount rate (%)** 3.5

100% compliance. All UK companies (3.19m) experience at least some familiarisation and on-going costs. The level of costs and benefits will depend on the final shape of the policy (See Sensitivity Analysis at **Annex B**). Almost by definition, corporate opacity is challenging to evaluate; we have taken considerable steps to identify material to support quantification of the costs and benefits of the proposals, and have used evidence derived from a survey of almost 600 companies. We received a large number of both high and zero cost estimates in the survey so the sample was truncated to arrive at more robust and representative estimates. We have conducted some sensitivity analysis around our estimates.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs: 86	**Benefits:** Unknown	**Net:** -86	No	NA

Summary: Analysis & Evidence Policy Option 2

Description: Government-led campaign to encourage enhanced transparency of company ownership: Non-regulatory option

FULL ECONOMIC ASSESSMENT

Price Base Year 2013	PV Base Year 2013	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low:	**High:**	**Best Estimate:** -0.5m Unknown

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low				
High				
Best Estimate	0.5		0	**0.5**

Description and scale of key monetised costs by 'main affected groups'

There are likely to be costs to the public sector associated with promoting the voluntary approach. For example, communications campaigns and business engagement. The cost of **£400k** quoted in this Impact Assessment is from an existing BIS campaign and is meant to be merely indicative of possible cost. There will also be **£69k** of costs incurred by Companies House in terms of changes to their IT systems.

Other key non-monetised costs by 'main affected groups'

Any private sector costs derived from this policy change cannot be fully monetised.

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low	Unknown		Unknown	**Unknown**
High	Unknown		Unknown	**Unknown**
Best Estimate	Unknown		Unknown	**Unknown**

Description and scale of key monetised benefits by 'main affected groups'

Any benefits derived from this policy change cannot be monetised.

Other key non-monetised benefits by 'main affected groups'

No benefits from reduced crime are expected under this Option, given that a voluntary approach would not fully help to deter, disrupt and sanction criminal activity. There might be some deterrence benefits in terms of individuals choosing to incorporate a company or conduct illicit activity outside the UK, but these are expected to be limited. Overall this Option is not likely to achieve the desired objective of the policy.

Key assumptions/sensitivities/risks **Discount rate (%)**

BUSINESS ASSESSMENT (Option 2)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs: 0.5	**Benefits:**	**Net:** -0.5	No	NA

Evidence Base (for summary sheets)

Transparency and Trust – Enhanced transparency of company beneficial ownership
Executive summary

Problem under consideration and rationale for intervention

- At the UK-chaired G8 Summit in 2013, the G8 Leaders recognised the problem of corporate opacity and agreed to publish national Action Plans setting out the concrete steps they would take to address this. The UK's Action Plan set out a number of commitments, including in relation to enhanced transparency of company beneficial ownership.
- Corporate opacity can facilitate illicit activity, and lead to poor corporate behaviour which erodes trust and damages the business environment. Both crime and a lack of trust can impede economic growth.
- Where there is a lack of transparency around corporate structures which facilitates illicit activity and hinders the criminal justice system, there is **regulatory failure** with respect to the company law framework and enforcement. Where there is a lack of transparency, there is an **information asymmetry** which damages trust and hinders transactions and investment. Therefore there is a dual rationale for Government intervention to address the problems of corporate opacity.
- The central problem under consideration here is where opaque company ownership structures, in which the registered directors and legal owners of the company are not the individuals who ultimately own and control the company, are used to facilitate illicit activity; or create scope for reduced levels of trust in UK business.

Policy objectives and options

- The overarching policy objectives for the *Transparency and Trust* package are to reduce crime and improve the business environment so as to facilitate economic growth.
- Specifically, this policy aims to implement the UK's G8 commitment to ensure that UK companies obtain and hold adequate, accurate and current information on their beneficial ownership; and that this information is publicly accessible onshore in a central registry. We want to implement reform that is both effective and proportionate, and that maximises the potential benefits to be gained by UK and overseas enforcement authorities; financial institutions and other regulated professional bodies; and the wider community that engages with UK companies.
- The options considered to achieve this objective include:
    - **Option 0**: 'Do Nothing'. This does not meet the stated policy objectives.
    - **Option 1**: The creation of a publicly accessible central registry of company beneficial ownership information. This is our preferred option, as it will fulfil the UK's G8 commitments and is the most effective Option by which to tackle company misuse.
    - **Option 2**: Government-led campaign to encourage greater company ownership transparency (non-regulatory option). This is our least preferred option. Whilst it may deliver some benefits in terms of enhanced corporate transparency, it will not meet G8 commitments or help address criminal activity.

Costs and benefits

- **Option 1:** Delivers benefits to Government, individuals and business through a reduction in illicit activities and increased economic activity arising from increased transparency. There will be public sector costs in setting up a registry; and costs to business and individuals in implementing the new requirements.

- **Option 2:** Whilst the costs of Option 2 (in terms of costs to business, individuals and the public sector) would be much lower than Option 1, we anticipate that the benefits would equally be much lower relative to Option 1. For example, Option 2 would not deliver benefits in terms of a reduction in illicit activities.

- The costs and benefits described in this Impact Assessment are based on the most robust and up to date analysis available.

Implementation

- Primary legislation will be required to implement this policy; although some elements will ultimately be taken forward through secondary legislation. Once the policy has completed its Parliamentary passage, and all relevant legislation has been commenced, we will look to operationalise the central registry. From this point (and subject to any transitional arrangements put in place), companies will be required to provide beneficial ownership information to Companies House; and enforcement and compliance procedures will apply.
- We will look to review the legislation five years after Royal Assent.

A. Background

A lack of corporate transparency

1. Under the Presidency of the UK, G8 Leaders agreed at Lough Erne in June 2013 that a lack of corporate transparency was a problem they were determined to address. This corporate opacity might come from a lack of transparency around who ultimately owns and controls the company (i.e. its beneficial owners), or from the use of bearer shares or opaque arrangements involving company directors. The G8 described these problems as follows:

   "A lack of knowledge about who ultimately controls, owns and profits from companies […] not only assists those who seek to evade tax, but also those who seek to launder the proceeds of crime, often across borders. Shell companies can be misused to facilitate illicit financial flows stemming from corruption, tax evasion and money laundering. Misuse of shell companies can be a severe impediment to sustainable economic growth and sound governance. We will make a concerted and collective effort to tackle this issue and improve the transparency of companies […] Improving transparency will also improve the investment climate; ease the security of doing business and tackle corruption and bribery. It will support law enforcement's efforts to pursue criminal networks, enforce sanctions, and identify and recover stolen assets. We are determined to take action to tackle the misuse of companies […][1]."

2. The G8 Leaders each agreed, and have now published, national Action Plans setting out the concrete steps they will take to address the misuse of companies. Specifically, these Action Plans consider the need to identify companies' 'beneficial owners' – the individuals who ultimately own and control the company. In the anti-money laundering (AML) context, an individual is typically defined as the beneficial owner if they have an interest in more than 25% of the company's shares or voting rights, or if they otherwise exercise control over the management of the company[2]. The G8 commitments are in line with the recommendations of the Financial Action Task Force (FATF), which sets the global standards on combating money laundering and terrorist financing: *"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 […][3]."*

3. The UK's Action Plan accordingly committed to require companies to obtain and hold adequate, accurate and current information on their beneficial ownership; and to implement a central registry of this information, maintained by Companies House. We also committed to consult on whether this information should be made public.

4. In July 2013, the Department for Business, Innovation and Skills (BIS) published the *Transparency and Trust* discussion paper. In it, we considered a range of proposals to enhance the transparency of UK company ownership and increase trust in UK business; including implementation of the UK's G8 commitment to create a central registry of company beneficial ownership information.

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[1] 2013 Lough Erne G8 Leaders' Communiqué (June 2013): https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/207771/Lough_Erne_2013_G8_Leaders_Communique.pdf

[2] See Regulation 6, Money Laundering Regulations 2007 (No. 2157)

[3] The FATF Recommendations (February 2012): http://www.fatf-gafi.org/topics/fatfrecommendations/documents/internationalstandardsoncombatingmoneylaunderingandthefinancingofterrorismproliferation-thefatfrecommendations.html

5. At the Open Government Partnership Summit in October 2013, following BIS' call for evidence and careful analysis of the responses received, the Prime Minister announced that the UK registry would be publicly accessible:

   "Now of course, we in Government will use this data to pursue those who break the rules, and we're going to do that relentlessly, but there are also many wider benefits to making this information available to everyone. It's better for businesses here, who'll be better able to identify who really owns the companies they're trading with. It's better for developing countries, who'll have easy access to all this data without having to submit endless requests for each line of inquiry. And it's better for us all to have an open system which everyone has access to, because the more eyes that look at this information the more accurate it will be[4]."

6. This Impact Assessment accordingly considers the costs and benefits of implementing a publicly accessible central registry of company beneficial ownership information in line with the UK's G8 commitments. Other Impact Assessments in the *Transparency and Trust* package cover proposed action to improve the transparency of ownership and control of companies through other means. Taken together, these measures should meet the overarching G8 objectives to tackle the misuse of companies.

7. The UK's G8 commitments capture the two sides of the problem under consideration – firstly, that of opacity facilitating illicit activity, and secondly that of a deficiency in good corporate behaviour which erodes trust and damages the business environment. Both elements can ultimately hold back economic growth.

B. Problem under consideration

Corporate opacity and illicit activity

8. As an indication of the scale of this type of criminal activity, the European Commission's 2013 Impact Assessment of *Anti-Money Laundering and Terrorist Financing*[5] points to global criminal proceeds potentially amounting to some 3.6% of GDP; around US$2.1 trillion in 2009. The best available international estimate of the amounts used in just money laundering would be equivalent to some 2.7% of global GDP or US$1.6 trillion in 2009[6].

9. Illicit financial flows reflect and result in significant global challenges; illicit flows out of low income countries, particularly in Africa, are sizeable. It is often claimed that these countries lose billions of dollars per year through illicit flows. Though almost by definition figures are difficult to derive, the Africa Progress Panel chaired by Kofi Annan[7] highlighted the problem, citing research suggesting that the annual loss to Africa between 2008 and 2010 was $38bn, and that between 1970 and 2008 $1.8 trillion were lost from the continent - with obvious human consequences[8]. Moreover, as the Serious and Organised Crime Strategy (2013)[9] sets out: *"overseas, organised crime undermines good governance and the stability of countries of strategic importance to our national security. Organised crime groups overseas can facilitate or engage in terrorism."*

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4 PM Speech at Open Government Partnership 2013 (October 2013): https://www.gov.uk/government/speeches/pm-speech-at-open-government-partnership-2013

5 European Commission (2013) for revision of the third money laundering directive: *Impact Assessment – proposal on the prevention of the use of the financial system for the purpose of money laundering, Including terrorist financing*

6 UNODC (October 2011*): Estimating illicit financial flows resulting from drug trafficking and other transnational organized crimes: Research report*. This estimate would be within the IMF's original 'consensus range', equivalent to some 2.7% of global GDP (2.1 – 4%) or US$1.6 trillion in 2009.

7 Africa Progress Panel (2013): *Africa Progress Report 2013: Equity in Extractives*

8 Global Financial Integrity and the African Development Bank (2013): *Illicit Financial Flows from Africa: Hidden Resources for Development*

9 Home Office (October 2013): https://www.gov.uk/government/publications/serious-organised-crime-strategy

Reducing the potential for illicit financial flows, including through misuse of the company structure, is therefore one means of countering significant international problems.

10. There is a clear link between such illicit financial flows and company structures, described with concern by a range of international expert organisations. The Organisation for Economic Co-operation and Development (OECD; 2011)[10] has observed that: *"almost every economic crime involves the misuse of corporate vehicles [i.e. companies]."* A World Bank review[11] of 150 cases of grand corruption identified the use of companies in the majority, including some UK companies. Meanwhile, the World Economic Forum (WEF; 2013)[12] highlighted the increasing number of problematic cases confronting law enforcement agencies involving illegitimate business activity co-mingling with legal business activity, and illicit funds with licit funds.

11. These issues are systemic and relate in many ways to the essence of the company form, which is largely replicated throughout international legal systems. Given the significant international issues, and the high profile association of some jurisdictions with illicit financial flows, the UK is driving change on a wider stage. The Government is pursuing this not only through the G8, as mentioned, but also in the G20, in FATF, in Europe, and with the UK's Overseas Territories and Crown Dependencies. In parallel, there is a strong case for domestic action to reduce the vulnerability of the company form.

12. With respect to the UK, directly applying the 2009 global estimates as set out above (which may or may not be representative) would equate to around £42bn of laundered money in 2012. The social and economic costs of organised crime in the UK are estimated to be £24bn[13], of which £8.9bn are associated with fraud. The misuse of the company structure described as a general principle above applies equally in the UK and contributes to our issues as it does internationally.

13. For example, within one month of the G8 Summit in 2013, eight people were found guilty following an investigation by North Yorkshire Police's Major Fraud Investigation Team and Her Majesty's Revenue and Customs (HMRC) which showed the use of a series of companies to launder the proceeds of a £1.28m theft from the Department for Environment, Food and Rural Affairs and attempt a £250k VAT fraud[14]. Earlier in 2013, two people were found guilty, following an investigation by the Serious Fraud Office (SFO), of using deception and forgery including the use of company structures to perpetrate a fraud worth millions of pounds[15].

14. On the basis of the current opacity and abuse of the company structure, a strong case for action to increase corporate transparency has been made by the UK's law enforcement agencies. The SFO, the National Crime Agency (NCA)[16], the Crown Prosecution Service, HMRC and various branches of the police have been engaged in the development of the *Transparency and Trust* package generally, and this Impact Assessment specifically, and have described the problems the package could address and the benefits these measures could bring for them, and crucially for business and the public from a potential reduction in crime[17].

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10 OECD (2011): *Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes*

11 World Bank Publications (2011): *The Puppet Masters : How the Corrupt Use Legal Structures to Hide Stolen Assets and What to do About It.*

12 World Economic Forum (2013): *Organised Crime Enablers: "Law enforcement agencies have been handling an increasing number of cases in which legitimate businesses co-mingle with illegal businesses, and legitimate funds with illicit funds. Reconstructing these complex corporate schemes and identifying who lies behind them, i.e. identifying their beneficial owners (BO), is considered to be essential to reveal the full extent of the criminal infrastructure and to prevent future criminal activities."*

13 Home Office (October 2013): *Serious and Organised Crime Strategy*. This estimate does not include money laundering.

14 July 2013: http://www.northyorkshire.police.uk/11613

15 January 2013: http://www.sfo.gov.uk/press-room/latest-press-releases/press-releases-2013/achilleas-kallakis-and-alexander-williams-jailed.aspx

16 And previously the Serious Organised Crime Agency (SOCA)

17 Including evidence provided by SOCA prior to the launch of the National Crime Agency in October 2013.

15. In the UK, there are currently circumstances in which a company's beneficial owners should already be identified. For example, under the UK's AML regime[18], banks, lawyers, accountants and other professional bodies ("regulated entities") are required to apply customer due diligence measures before entering into a business relationship with a company, including identification of the beneficial owner(s). However, regulated entities have told us that they can struggle to fulfil this requirement, finding it difficult to obtain the information from the company or through other means. If the regulated entity cannot obtain this information to its satisfaction, it should not enter into the business relationship (irrespective of whether criminal activity is suspected). This clearly has the potential for sub-optimal outcomes for the regulated entity, who loses the potential client. The regulated entities go on to say that where services are refused, the company may look to find a service provider who does not apply due diligence, or to a lesser degree.

16. Law enforcement agencies 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 individual suspected of benefiting from the shares or company in question is actually the beneficial owner. This can have an adverse impact in terms of the amount of time and resource expended in investigating a case; but also in terms of the ultimate case outcome (e.g. the ability to successfully prosecute). Law enforcement agencies say that current beneficial ownership arrangements are a significant barrier to tackling money laundering and successfully recovering stolen assets. Whilst some of these cases will involve non-UK companies, the City of London Police estimated that around 99% of company fraud cases they investigate involve UK companies.

17. As an indication of the extent of the challenges posed by hidden beneficial ownership, at any one time in the 2012/13 financial year, SOCA (now NCA) was involved in over 400 significant operations. Nearly all of these had a financial investigation element – and the NCA estimated that in around 70% of such investigations issues around beneficial ownership arise. Similarly, in 2012 NCA had approximately 60 cases where civil recovery powers were used to retrieve criminal assets. Again, beneficial ownership issues arose in the majority of those cases. The SFO has stated that establishing the beneficial ownership of assets is almost always a key element of confiscation investigations. The Metropolitan Police Force ('the Met') estimate that in cases where hidden beneficial ownership is an issue, 30-50% of an investigation can be spent in identifying the beneficial owners through a chain of ownership "layers".

18. Discussions with enforcement agencies and private sector fraud investigators have indicated that many cases of company misuse will involve complex webs of companies and other corporate structures incorporated in numerous different jurisdictions. This is supported by relevant literature on the misuse of companies[19]. This necessarily increases the time and cost of obtaining beneficial ownership information, for both UK and international enforcement agencies.

19. Aside from the problem of opacity of company ownership hindering AML due diligence checks and enforcement action, the general lack of transparency of UK company ownership may also have an adverse impact on levels of trust in UK business, and perceptions of the UK as a clean and open place to do business. This is because without this transparency, it may be difficult for those who engage with a company to identify with whom they are really doing business. They may then have to spend more time or resource in obtaining this information, or be more reluctant to engage with the company in the first place.

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[18] See the Money Laundering Regulations 2007 (No. 2157)

[19] For example, World Bank Publications (2011): *The Puppet Masters : How the Corrupt Use Legal Structures to Hide Stolen Assets and What to do About It*

20. The Financial Reporting Council, the UK's independent regulator responsible for promoting high quality corporate governance and reporting to foster investment has noted that: *"High quality corporate governance helps to underpin long-term company performance. The UK has some of the highest standards of corporate governance in the world, which makes the UK market attractive to new investment."* But keeping the UK's position secure requires continual evaluation of improvements that can be made.

21. The problem of opaque company ownership structures can therefore be summarised as increasing the potential for criminal activity and potentially also reducing levels of trust in business. Without Government intervention, there is unlikely to be sufficient collective action by industry to address these issues; particularly given that much of the activity we are aiming to address is criminal.

C. Rationale for intervention

22. There are two facets to the economic rationale for Government intervention through the policy changes described in the *Transparency and Trust* package. Firstly there is the **regulatory failure** associated with the current corporate governance and company law frameworks, which enable those that control companies to remain anonymous and hence allow or even facilitate financial crime. Secondly, and linked to that, there is an **information asymmetry** with respect to company ownership and control, between those that control companies and those that trade with them or invest in them, which inhibits economic activity. The inefficiency and reputational damage that crime introduces to the economy, as well as the lost business and reduced investment from information asymmetry, could all negatively impact on economic growth.

(1) Regulatory failure and the potential facilitation of crime

23. There is a well-established role for the State in addressing criminal behaviour. This includes the introduction of laws which form a central part of the UK's institutional infrastructure and business environment. By upholding the law and enforcing property rights, the State facilitates economic activity. The State's role also includes the provision of criminal investigation and law enforcement, not least where there are externalities and the potential for free-riding. It could be argued that there is a regulatory failure where there is a deficiency in the legal framework, or in the functions of associated institutions, which facilitates crime (which in turn imposes costs on society). There is therefore a clear rationale for intervention where the net benefits of Government action outweigh the cost of inaction.

24. Companies and other corporate entities have separate legal personality, meaning that they can enter into contracts and business relationships in their own name. Importantly in addition, many companies take advantage of the option to have limited liability. In exchange for these advantages, which facilitate entrepreneurship[20], a company is required to put additional information in the public domain (e.g. their accounts, and information on their shareholders and directors) compared to other business forms (e.g. sole traders). However there still remains scope for opacity around corporate ownership structures and company control. This is because various aspects of the current corporate ownership system (e.g. bearer shares, opacity of beneficial ownership and opaque arrangements involving company directors) can be used to conceal an individual's interest in a company.

[20] Brian Brougham (2011): *Entrepreneur Wealth and the Value of Limited Liability*

25. This potential for anonymity means that the individuals who 'stand behind' the company can then use the company as a front to launder the proceeds of crime and to finance organised crime and terrorism[21]. In effect, the corporate structure can be used to help support criminal activity - from the supply of drugs, to fraud and corruption. This anonymity also means that law enforcement agencies cannot always readily identify the individuals really responsible for the criminal activity - resulting in less efficient and effective investigations; and potentially sub-optimal outcomes. Where the corporate governance and company law frameworks do not ensure sufficient transparency to prevent this opportunity, and hence also fail to reduce the need for risk mitigation measures by counterparties or inefficient corporate activity, it can be viewed as a **regulatory failure**.

26. Thus, in this case, regulatory failure facilitates crime which can lead to costs to the economy and more widely to society. These costs include the welfare damage to the victim; inefficient resource allocations and a forced redistribution of income; lost economic activity/output; inefficient insurance expenditure; and costs to the criminal justice system, including the police[22]. The aim of this policy to address the regulatory failure affecting corporate ownership and control transparency is to reduce the opportunity for criminal activity and thus reduce these costs to the UK.

27. Opaque corporate structures can not only facilitate crime but also hamper the law enforcement response. Firstly, during the investigation phase where time and resource can be used to establish basic facts, such as who are the individuals owning particular assets or who control a company, and secondly, during prosecution or after a conviction, by preventing confiscation of the proceeds of crime by the authorities and return of assets or compensation to the victims.

28. Reducing opportunities for crime could also help support conditions for growth. Each US$1 billion laundered reduced overall economic growth by 0.04-0.06 percentage points in 17 OECD countries, prompting the UN to comment on the findings that: *"financial centres have developed a self-interest of not being associated with 'tainted money' and have signed relevant international instruments to avoid the inflow of such criminal finance[23]."*

29. There is a strong body of evidence highlighting how crime acts as a drag on investment, job creation and ultimately economic growth. For instance, Goulas and Zervoyianni (2013)[24] find that in times of macroeconomic uncertainty, a 10% increase in the crime rate is associated with a reduction in annual GDP per capita growth of 0.49%-0.62%. Although these studies[25] do not directly identify the mechanism, they highlight that reducing crime will support growth.

(2) Imperfect/asymmetric information affecting the operation of the business environment

30. Opaque corporate ownership structures are also associated with **imperfect/asymmetric information**. In all economic transactions, one party to the transaction must acquire information about the other party to understand sufficiently the quality and risks associated with the goods,

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21 That is to say the money passing through the company can be of criminal origin, and / or can be used to support further crimes, and through the relative anonymity of the company structure the individuals involved can be concealed.
22 See Brand and Price (2000): *The economic and social costs of crime* Home Office Research Study 217. London: Home Office. And Dubourg et al (2005): *The economic and social costs of crime against individuals and households 2003/04*. Home Office Online Report 30/05. London: Home Office.
23 UNODC (October 2011): *Estimating illicit financial flows resulting from drug trafficking and other transnational organized crimes: Research report*
24 Goulas and Zervoyianni (2013): *Economic growth and crime: does uncertainty matter.* Applied Economics Letters, Vol 20, issue 5, pp420-427
25 See also Detotto and Paulina (2013): *Does more crime mean fewer jobs and less economic growth?* European Journal of Law and Economics, Vol 36, Issue 1, pp183-207 and Detotto and Otranto (2010): *Does crime affect economic growth* International Review of Social Sciences, Vol 63, Issue 3, pp330-345.

service or investment opportunity on offer. In particular, when engaging in high cost and long term economic relationships involving complex goods ("experience" or "credence" goods), services or investments (e.g. long term investment in corporations or purchasing high-end professional services), the information asymmetry between parties is likely to be large and significant.

31. The corporate form helps mitigate the impact of information asymmetry. This is because the company has separate legal personality: *"As a separate legal entity […] the company must be treated like any other independent person with rights and liabilities appropriate to itself*[26]*."* In other words, a person may engage with the company without needing to satisfy himself or herself of the nature of the persons *behind* the company - they simply need to be satisfied with the 'credentials' of the company itself, which is evidently a less onerous and more efficient process than needing to satisfy themselves with respect to all the individuals who might be associated with a company in various ways.

32. However, corporate opacity – created, for example, by a distinction between the legal owners of a company as recorded on the company's share register and the 'beneficial owners' on whose behalf those shares are held; or through the use of bearer shares which do not require a person to be named in a company's register of members – can nevertheless lead to two sub-optimal outcomes.

33. The **first** is in terms of the ability of the members of the company to hold the directors to account. An individual holding 15% of the company's shares will not, on their own, be able to influence materially a key company vote. However, that individual can look to other members to support their position, thereby gaining a much greater ability to support or block the vote. This process is facilitated by the member's ability to access the company's register of members – giving them the means to identify to whom else they need to talk.

34. However, this register of members may not of itself be sufficient. For example, where a bank holds shares on behalf of a client, it will be the name of the bank that is recorded in the register – not that of the client. Where bearer shares are issued, there will be no person named in the register of members. In these cases, an ability to identify the holder of the bearer share or the beneficial owner would improve the ability of the shareholders (understood here as the individuals and companies investing in the company, whether directly or through an intermediary) to hold the company to account, and ultimately drive more successful outcomes.

35. This enhanced transparency, enabling shareholders to hold companies to account could be expected to have a positive impact on economic growth. As discussed in the Kay Review (2012)[27], greater shareholder unity enables shareholders to hold companies to account more effectively, which is thought to generate efficiency, corporate profit and therefore economic growth[28]. Essentially, by reducing the information asymmetry between the company board (agent) and the shareholders (principal), this enables the shareholders to align more effectively the board's incentives to generate positive outcomes from the company.

36. As noted in the seminal paper by Hirschman (1970), shareholders have two means to influence company boards; 'voice' (lobbying management and voting) and 'exit' (selling their shares). The additional transparency resulting from our package of policies gives shareholders more 'voice' to

[26] Hannigan, B (2003): *Company Law*, Clays Ltd

[27] BIS (2012): *The Kay Review of UK Equity Markets and Long-Term Decision Making*

[28] Bilych, G. (2012*): Profit and economic growth* Macrothink Institute vol. 2 no. 2

influence the board, hold it to account (particularly with respect to the company's ownership chain) and therefore drive corporate growth and long-term development.

37. The **second** sub-optimal outcome is in terms of those who engage with a company wanting to know with whom they are actually dealing.

38. Irrespective of the 'protection' that the corporate form affords in an economic sense; we might expect investors, suppliers and customers to want to know who actually owns and controls the company (again, its beneficial ownership) – not least as a means to mitigate reputational risk incurred as a result of transacting with a company subsequently found to have, for example, established links to terrorist groups or money launderers.

39. Knowledge of a company and its owners is therefore important in helping those who engage with a company to assess the risk of company transactions more accurately, and therefore their own engagement with them. Not knowing who ultimately owns/controls a company means that there is a greater inherent risk of making sub-optimal investments, not being paid correctly for goods/services or inadvertently financing crime. This makes economic transactions/activities less attractive[29] and hence less likely to go ahead or they will go ahead but at a higher cost or lower level. For instance, Easley and O'Hara (2004)[30] find that companies which keep a greater proportion of their information private require a greater compensating return for the lack of transparency, i.e. they face a higher cost of capital. This is a common finding in the economic literature[31].

40. In addition, when corporate information is not readily available other parties must incur greater costs from conducting due diligence to mitigate this risk. They must, for instance, actively seek to determine the trustworthiness of the company and also write, complete and monitor contracts[32]. Therefore a lack of information will increase transaction costs, which can serve as a serious barrier to entry in the market, discouraging economic activity and harming growth.

41. Whilst both the higher cost of capital and greater risk mitigation represent a market response to a lack of information, they can also be inefficient. This raises the question of why all companies do not volunteer such information proactively. One possibility is that an individual's rationality is bounded[33] by the information they have, the finite amount of time at their disposal and limits to their ability to process and analyse all the information available. It is plausible that even though information about the business advantages of corporate transparency exists, companies may be unaware of it. Alternatively, the costs of identifying, accessing, understanding and applying this information (e.g. the opportunity cost of a director's time) outweigh the perceived benefits. Furthermore, evidence may be available only in an abstract sense, and not easily accessible to many companies. Therefore, many companies may not volunteer relevant corporate information in these circumstances.

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29 Furthermore, considering adverse selection, if the share of 'bad' companies exceeds a certain threshold, the market will cease to exist as 'good' companies are driven out of business.

30 Easley, D. and O'Hara, M. (2004*): Information and the Cost of Capital* The Journal of Finance, Vol. 59, No 4.

31 See Barry, C. and Brown, S. J. (1985*): Differential Information and Security Market Equilibrium.* Journal of Financial and Quantitative Analysis 20, no. 4: 407-22 for a model, which demonstrates that securities with relatively little information are of a higher systemic risk. See Merton, R. (1987*): A Simple Model of Capital Market Equilibrium with Incomplete Information.* Journal of Finance 42, no. 3: 483-510. Finds that in a model where investors are not aware of all stocks available i.e. suffer from incomplete information, the equilibrium value of each company is always lower.

32 Nonetheless, knowledge is always imperfect to some extent: as noted by Miller and Whitford (2002): without all encompassing contracts, which account for every eventuality, some element of trust is implicit in every business contract.

33 Gigerenzer, Gerd and Selten, Reinhard (2002): Any benefits derived from this policy change cannot be monetised. *Bounded Rationality*. Cambridge: MIT Press.

42. Given that such bounded rationality is likely to be pervasive, firms behaving in this way (i.e. not revealing relevant corporate information) would not necessarily be forced out of the market by more competitive rivals in the long run, even if we assume that markets are competitive.

43. Opacity could also drive adverse selection[34]. The potential investor/lender/customer/supplier of a company cannot distinguish between a low-risk transaction and a high-risk one because of asymmetric information around ownership and control. Therefore they offer 'average' terms and conditions for that transaction. This means that some mutually beneficial trades will only go-ahead at a sub-optimal quantity, or not at all. Over time, standard economic theory suggests that fewer mutually beneficial trades will take place as fewer high quality offers are put to the market on the supply side and risk averse firms and investors start to opt out of the demand side. A market for 'lemons' is the result[35]. On this basis, a lack of transparency and trust can inhibit optimal economic activity.

44. Finally, there is a broader point around the role of trust in the smooth operation of the economy. The literature commonly identifies a significant and positive relationship between trust and overall economic growth, which emerges because trust motivates innovation, investment and more entrepreneurship[36].

45. Whilst trust alone will not drive growth, it feeds into the stability of economic systems which are key to economic activity. In terms of its relative importance, Whiteley (2000)[37] finds evidence suggesting that social capital, defined as the extent to which people are prepared to co-operate based on interpersonal trust, has a highly significant impact on growth, at least as strong as education or human capital. More broadly, enhancing trust will act to improve the prospects, reputation and stability of UK businesses and financial services.

46. In summary, the *Transparency and Trust* policy proposals around increasing the transparency of corporate ownership and control have the potential to:

- Reduce crime, by addressing a regulatory failure in the corporate governance and company law frameworks; and
- Reduce the risks around economic activity and increase trust by reducing information asymmetry between those that trade with, or invest in, the company and those that control it.

D. Policy objective

47. We want to know who really owns and controls UK companies to tackle the potential for misuse and promote good corporate behaviour. In so doing we want to fulfil the UK's G8 corporate transparency commitments, and meet international standards on anti-money laundering and counter-terrorist financing. As stated in the UK's G8 Action Plan we want to implement reform via primary amendments to company law as soon as Parliamentary time allows; as well as through amendments to money laundering legislation and other relevant bilateral and multilateral agreements.

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34 It refers to a market process in which undesired results occur when buyers and sellers have access to different information; the "bad" products or services are more likely to be offered and selected.
35 Akerlof G.A. (1970): *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*. The Quarterly Journal of Economics, Vol. 84, No. 3., pp. 488-500
36 For instance, see Knack S, (2001): *Trust, associational life, and economic performance*, World Bank; Dincer and Uslaner (2010): *Trust and Growth* ; Stephen Knack and Paul Zak (2001): *Trust and Growth*, Economic Journal, 111(470): 295-321 and Knack & Keefer (1997): *Does Social Capital Have an Economic Payoff? A Cross-Country Investigation* The Quarterly Journal of Economics, Vol. 112, No. 4, pp. 1251-1288. Bjørnskov (2012): *How Does Social Trust Affect Economic Growth?* Southern Economic Journal, Working Paper 06-2, shows that trust has a direct impact on schooling, which in turn feeds into the investment rate and ultimately economic growth.
37 Whiteley, P. (2000): *Economic Growth and Social Capital*, Political Studies 48, 443-466.

48. The chosen option should contribute to the two main objectives of the *Transparency and Trust* package, which are to:

- Reduce crime, and
- Improve the business environment so as to facilitate economic growth.

49. In particular, company beneficial ownership reform should, in line with the UK's G8 commitments:

- Ensure that UK companies obtain and hold adequate, accurate and current information on their beneficial ownership; and
- Ensure that this information is publicly accessible onshore in a central registry. The registry should provide a single source of information to support law enforcement and tax authorities' investigations; support financial institutions and other regulated professional bodies as they carry out AML due diligence checks on companies; and allow all those who engage with a company (e.g. investors, suppliers, customers) to identify with whom they are really doing business.

50. The chosen policy option should also:

- Stimulate global, collective action to tackle the misuse of companies. Investigations into abuses of company structures will often cross borders and so coordinated international action is vital. In leading by example, UK and G8 action should encourage other jurisdictions, including the UK's Overseas Territories and Crown Dependencies, to follow suit. This should deliver better outcomes in terms of reducing crime in the UK as well as elsewhere;
- Deliver benefits for developing countries who suffer as a result of tax evasion, corruption and fraud. By allowing them access to information on UK companies, they should be more easily able to identify the individuals really responsible where a UK corporate entity has been used to facilitate the crime; and
- Ensure full UK compliance with relevant international standards in advance of the UK's next FATF peer review in 2016 to maintain and enhance the UK's reputation as a clean and trusted place to do business and invest.

51. We want to achieve these objectives by developing a policy solution that:

- Is effective and proportionate;
- Maximises the potential benefits to be gained by UK and overseas enforcement authorities, financial institutions and other regulated professional bodies, and the wider community that engages with UK companies;
- Minimises the potential for an adverse impact on the competitiveness of the UK business environment and the desirability of the UK as a place to set up and operate a company;
- Minimises the potential for unintended consequences as a result of enhanced transparency (e.g. the potential for an adverse impact on companies or individuals); and
- Is straight-forward for UK companies to understand and apply.

E. Description of options considered (including 'Do Nothing')

Option 0 - Do Nothing

52. Under the 'Do Nothing' Option the UK will have ways to identify the beneficial ownership of UK companies. For example, enforcement agencies can obtain production orders for this

information; the Business Secretary can use his powers under the Companies Act 1985 to investigate company ownership and regulated entities are required to obtain beneficial ownership information before entering into a business relationship with a company. In addition, public companies can use provisions in the Companies Act 2006 to investigate their own membership (i.e. shareholders).

53. These measures are however not effective enough in dealing with the problem because:

- If companies are not required to provide beneficial ownership information by law, the only way for enforcement agencies to obtain the information is via production and court orders. As an example, the SFO makes around 30 applications for production orders to the courts each year, and this takes some two man-days per application to prepare, review and authorise. This process would not be aided by more extensive use of their current powers. In addition, these methods alert the company to the fact that they are under scrutiny. Enforcement agencies have noted that this can be counterproductive in investigations – as the company may then take steps to conceal their illicit activity or transfer the illicit funds before the investigation is complete (potentially preventing the individuals from being sanctioned);
- Similarly, regulated entities have reported that it can be difficult to obtain beneficial ownership information. Simply requiring them more effectively to carry out their due diligence obligations without supporting them to do so (e.g. by placing a statutory obligation on companies) is therefore insufficient to meet the stated policy objectives. Furthermore, UK companies could continue to avoid having to provide their beneficial ownership information by using a service provider who is not subject to the UK or EU AML regime (e.g. an overseas bank). This means the potential for misuse will remain;
- It will remain difficult for those engaging with a company to identify who they are really doing business with; and
- The UK will not meet its G8 commitments and will not be compliant with FATF standards, which may ultimately impact the UK's reputation as a clean and trusted place to do business and invest.

Option 1 – A publicly accessible central registry of company beneficial ownership information: Preferred option

54. At the G8 Summit in June 2013, all G8 countries committed to tackle the problem of hidden company beneficial ownership:

"Companies should know who owns and controls them and their beneficial ownership and basic information should be adequate, accurate, and current. As such, companies should be required to obtain and hold their beneficial ownership and basic information, and ensure documentation of this information is accurate[38]."

55. To do this, the UK committed to place a requirement on companies to obtain and hold beneficial ownership information in a publicly accessible central registry, maintained by Companies House. There are a number of variables as to how the registry could be implemented, and BIS sought views on these options in the *Transparency and Trust* discussion paper. The key questions are:

- How we define 'beneficial ownership' in this context;
- Which corporate entities are required to provide information to the central registry;

[38] G8 (June 2013): https://www.gov.uk/government/publications/g8-action-plan-principles-to-prevent-the-misuse-of-companies-and-legal-arrangements/g8-action-plan-principles-to-prevent-the-misuse-of-companies-and-legal-arrangements

- How beneficial ownership information is obtained by the company; and
- What information is provided to the central registry; and how often it is updated.

56. A model, taking account of consultation responses, is set out below. There are a number of key variables still to be decided and these are set out in the Sensitivity Analysis at **Annex B**. We will further refine the proposed model as we proceed towards enactment of the requirements and development of the Final Stage Impact Assessment. This will take account of further detailed discussion with enforcement agencies and key industry stakeholders and experts; changes to the policy as we prepare the legislation and as it completes its Parliamentary passage; and to reflect the outcome of any changes flowing from the BIS consultation on *Company Filing Requirements*[39] to ensure consistency across company law requirements where appropriate. Some elements of the proposed policy will be taken forward via secondary legislation once the primary legislation is in place.

(1) The definition of 'beneficial ownership'

57. We propose to maintain consistency with the beneficial ownership definition used in AML legislation. This means the register will hold information on the individuals who ultimately own and control UK companies, whether by having an interest in more than 25% of the company's shares or voting rights, or by otherwise exercising control over the management of the company.

58. Some respondents to the BIS discussion paper recommended decreasing the 25% threshold to 10%, or removing it entirely. We propose to retain the 25% threshold because:

- 25% is the point at which an individual could have a blocking minority in certain company decision-making processes. Individuals with a lower level of interest in shares or voting rights are unlikely to have any material influence over the running of the company – and if they do have effective control, they will be required to disclose their interest in line with the 'control' element of the definition;
- Lowering or removing the threshold would increase the number of individuals required to be disclosed to the registry. This would increase the overall regulatory cost and burden; and
- Industry should already be familiar with the AML definition (for example, because this information is already requested by regulated entities such as banks). This should reduce familiarisation costs.

(2) The scope of the registry

59. We propose to require UK incorporated companies and UK Limited Liability Partnerships (LLPs) to provide beneficial ownership information to the central registry. We propose at this stage to create specific exemptions for companies listed on a regulated market, as they already comply with strict ownership disclosure requirements. As the policy is refined, we may seek to exclude additional types of company, for example, wholly owned subsidiaries of companies listed on a regulated market and/or companies listed on prescribed markets such as AIM. We may similarly ultimately also include additional types of corporate entity.

60. Some respondents to the discussion paper recommended placing all UK companies in scope, with no exemptions. However, we want to avoid duplicative requirements and minimise additional regulatory burdens. We are mindful that companies listed on a regulated market are exempt from due diligence checks under UK AML rules. The latter highlights their low risk

[39] BIS (October 2013): https://www.gov.uk/government/consultations/company-filing-requirements

nature, which law enforcement agencies have supported in discussion. Some respondents also recommended placing all other UK formed corporate and legal entities in scope.

61. We think that our proposed approach is proportionate, and will not have an adverse impact on our objective to reduce crime facilitated by company misuse. We will however continue to explore options as we further refine the policy.

62. A few respondents also questioned whether small and micro companies should be exempt. The City of London Police stated that such companies are at high risk of misuse, for example, that they are the prime vehicles for boiler room fraud[40]. Furthermore, it has been widely identified that 'shell' companies are often the vehicle of choice for money-laundering and other crimes[41], which this policy has as a stated objective to reduce. A 2012 study defines a shell company thus: "*In contrast to operating or trading companies that have employees who make a product or provide a service […] shell companies are little more than this legal identity, and hence the "shell" moniker*[42]". By this very definition, we believe that the majority of shell companies would be classified as small and micro companies. Compared to public listed companies, private companies, including small and micro private companies, are also subject to fewer regulatory disclosure requirements.

63. Exempting such companies would therefore undermine one of the core policy objectives, which is to target the misuse of companies and support law enforcement and tax authorities in their investigations. We consider it imperative that small and micro companies are in scope.

(3) How beneficial ownership information is obtained

64. We propose that disclosure obligations should be placed on both companies and beneficial owners to ensure that all relevant beneficial ownership information is disclosed without placing a disproportionate administrative or cost burden on the company. This model would require the company to identify significant beneficial ownership (e.g. to identify the beneficial owner(s) of 'blocks' of more than 25% of shares where those shares were held by one legal owner); but also a disclosure obligation on the beneficial owner to disclose their interest in the company to the company (consistent with current self-disclosure requirements for investors with significant interests in listed companies). In parallel, we intend to provide all companies with a statutory power to make enquiries of any person suspected of having an interest in its shares by adapting relevant provisions of the current regime which applies only to public companies.

65. We are however continuing to refine this model with a view to maximising effectiveness and proportionality. We might, as suggested by some respondents, ultimately place additional or alternate disclosure obligations on the legal owners of the company.

(4) Providing and updating information in the central registry

66. In line with the model outlined in point (3) above, companies will be required to obtain and hold information on their beneficial ownership and provide it to the central registry.

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[40] A description of boiler room fraud is provided by the Financial Conduct Authority (FCA) (2013): *"Share scams are often run from 'boiler rooms' where fraudsters cold-call investors offering them worthless, overpriced or even non-existent shares. While they promise high returns, those who invest usually end up losing their money."* http://www.fca.org.uk/consumers/scams/investment-scams/share-fraud-and-boiler-room-scams

[41] Findley, Nielson and Sharman (2012): *Global Shell Games: Testing Money Launderers' and Terrorist Financiers' Access to Shell Companies*

[42] *ibid*

67. At the very least, we intend to model the information and disclosure regime on that which currently applies in respect of company legal owners (i.e. shareholders). This analysis is based on that assumption. This would mean that the company would maintain a register of the names, addresses and details of the beneficial owners' interest in the company. This information would be held at its registered office or other specified location and would be made publicly available on request, provided the request was made for a proper purpose. The company would be required to provide the beneficial owner's name, address and details of their interest in the company to the central registry on incorporation. This information would be updated with any changes annually, with a full list provided every third year. Companies would not however be required to provide the address of 'new' beneficial owners to the central registry. This information would be publicly accessible, with limited exemptions from public disclosure for individuals who might otherwise be at risk of harm.

68. However, we are considering, and in light of consultation responses, whether we might require more information to be collected and held in the registry, for example, dates of birth. We would need to consider carefully whether some or all of this additional information was publicly accessible, mindful of legitimate data privacy concerns. The impact of this approach is considered in the Sensitivity Analysis at **Annex B**.

69. In terms of how often this information is updated, this analysis is again based on the assumption that we would look to the company legal ownership regime as a model. This would mean that information held by the company itself would need to be updated as it changed. The company would then inform the registry of any changes on an annual basis, with a full list being provided every third year.

70. Alternatively, and again in light of consultation responses, we might require the company to notify the registry of changes within a certain number of days of the change. This would reflect the model that applies in relation to directors' details needing to be updated at Companies House. The impact of this approach is again considered in the Sensitivity Analysis at **Annex B**.

71. This is our preferred option.

Option 2 - Government-led campaign to encourage enhanced transparency of company ownership: ***Non-regulatory option***

72. We have considered the non-regulatory option of a Government-led campaign encouraging companies to obtain their beneficial ownership information. We would work with business representative bodies and regulated professional bodies to support and encourage their members and clients to take positive action in this space. We would continue to push for changes to be made and implemented to national and international standards or best practice on, for example, corporate governance.

73. In parallel, as under Option 0, the UK would still have ways to identify the beneficial ownership of UK companies. For example, enforcement agencies can obtain production orders for this information; the Business Secretary can use his powers under the Companies Act 1985 to investigate company ownership; and regulated entities are required to obtain beneficial ownership information before entering into a business relationship with a UK company. In addition, public companies can use provisions in the Companies Act 2006 to investigate their own membership.

74. However, we do not think that a non-regulatory approach would be sufficiently effective in meeting our policy objectives to reduce crime and improve the business environment so as to facilitate economic growth. This is considered further in the costs and benefits section below.

75. This is our least preferred option.

F. Monetised and non-monetised costs and benefits of each option (including administrative burden)

76. In order to gather evidence of the impact of these proposals on UK businesses, individuals and the public sector, and to inform thinking around policy and implementation, BIS has undertaken a literature review, a call for evidence in a public discussion document, various focus groups, discussions with academics, a self-selection online survey, and a fuller survey using interviews (see **Annex A** for the methodology). The results from these are used to inform the analysis below. For the Final Stage Impact Assessment we will continue to develop the evidence base and our analysis.

77. As noted in the 'description of options considered' above, there remain a number of policy variables in relation to Option 1. This Impact Assessment considers the costs and benefits based on the model outlined in that section. A Sensitivity Analysis based on key variables is included at **Annex B**.

Option 1 – A publicly accessible central registry of company beneficial ownership information: Preferred option

Benefits

78. The benefits of Option 1 are expected to be associated with the impact increased transparency could have on the reduction of illicit activity and increased economic activity arising from increased transparency.

B1. Benefits to Government, individuals and business of a reduction in illicit activities

79. To identify the economic benefits arising from a reduction in illicit activity, we first quantify the total economic cost of illicit activity. The proposed beneficial ownership reform will help to prevent crime by enhancing corporate transparency and should result in a situation where apprehending criminals is both cheaper and easier for law enforcement agencies. Based on our understanding of the impact this policy will have on crime, we derive illustrative estimates of the benefits using a range of assumptions about the scale of the crime reduction.

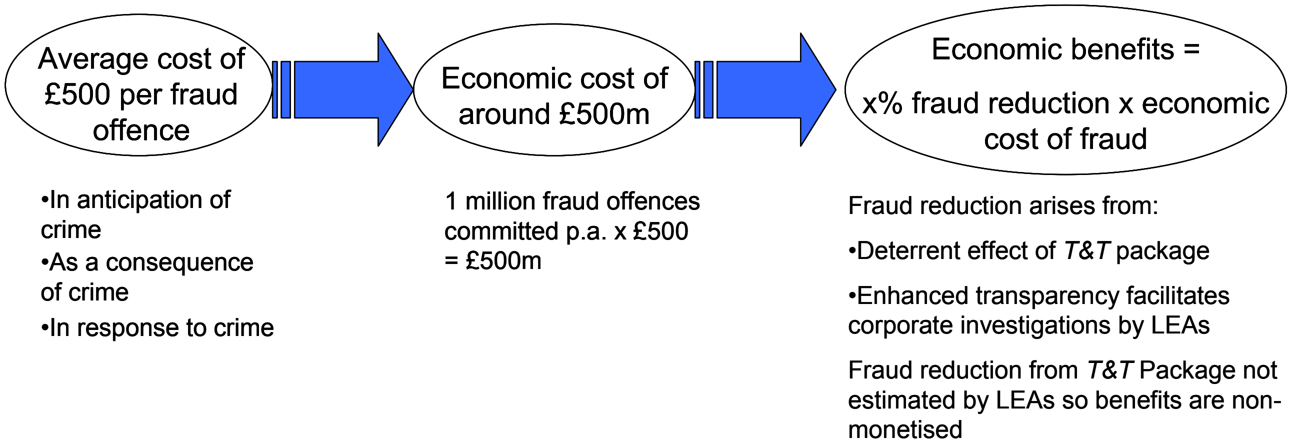

Figure 1: The logic chain behind the benefits of the* Transparency and Trust *package

80. In discussion with UK enforcement agencies, including the NCA (formerly SOCA), the SFO, the Met, the City of London Police, the Crown Prosecution Service and HMRC, there has been unanimous agreement that greater transparency of UK company ownership will be beneficial. They have highlighted the potential deterrent effect on criminals who might otherwise seek to form or use UK companies for illicit purposes and the potential for a positive impact on the timeliness and efficacy of investigations and outcomes (e.g. recovery of stolen assets, disruption of criminal activity).

81. The SFO has indicated that: *"For criminal and confiscation investigations, Companies House data is routinely gathered during a case but especially at the outset […] clarity of beneficial ownership of UK companies would therefore be of assistance in all, or almost all, SFO cases. In confiscation cases where UK companies feature, it would be an especially useful development as it would force defendants to either declare their interest on the record or else put up 'a front man' as an undeclared nominee. If the latter options were used, and other evidence could be adduced to prove the true state of affairs, that would be powerful evidence to bring before a court and provide a deterrent effect to criminals."*

82. They add that: *"Current methods* [to identify beneficial owners] *include: seeking a production order for banking documents or client identification documents from professional advisers; conducting interviews and taking statements from witnesses; and seeking information from abroad under the Mutual Legal Assistance process. All of these processes can be very time consuming (especially the latter) and may need to be repeated several times if there is a long chain of ownership."*

83. Similarly, the Met indicated that all of their major grand corruption/money laundering cases and their 'smaller' financial crime investigations had the tracking down of the beneficial owners at the core. Also, whilst much of the criminal activity took place overseas, the UK, due to it being a major financial centre, could be a conduit for funds, thus knowledge of UK company beneficial ownership would be a key additional tool. They estimated that 30-50% of an investigation could be spent identifying the beneficial owners through a chain of ownership. The role of the regulated entities (e.g. banks and accountants) in undertaking their due diligence under the AML laws to identify beneficial owners, whilst helpful, might not always provide up to date information.

84. For example, in 2011 the Financial Services Authority (now Financial Conduct Authority) published a report[43] on banks' management of high risk money-laundering situations. They found that: *"A third of banks in our sample failed to take adequate measures to understand and verify their customers' ownership and control structure. And when the structure appeared complex, banks rarely questioned the rationale for the complexity and few were able to provide convincing reasons for them when challenged. At least a fifth of banks visited also failed to identify indirect beneficial owners who exercised considerable control over the customer. As a result, these banks often did not appear to know who their customer's ultimate beneficial owner really was."*

85. The Met therefore noted that, *a priori*, the proposals would not only help the investigation but would also aid the prosecution and create a deterrent effect. In particular, criminals who have provided false information can then be sanctioned accordingly, even if other offences are initially more difficult to prove.

86. An increase in transparency could therefore reduce the financial and labour resources spent by law enforcement agencies on investigating and prosecuting this particular sort of offence. This means that enabling law enforcement agencies faster/easier access to beneficial ownership information, or getting that information without tipping off the criminals, could have an economic benefit in terms of freeing up these resources to be re-allocated elsewhere (potentially into additional investigations).

87. In 2002 a Government Impact Assessment[44] on similar proposals (though with real time updates to Companies House on beneficial interests exceeding 3%) was produced. This estimated benefits to the police of £30m in cost savings and improvements in recoveries. Up-rated over the last 11 years leads to a benefit of some **£40m** pa.

88. The problem of opaque corporate ownership structures is not limited to UK companies; and enforcement agencies and a private sector fraud investigator have indicated that cases involving the misuse of companies are often multi-jurisdictional. There might be benefits to be gained – including to the UK – from strong, coordinated, cross-border action. Law enforcement agencies have highlighted the benefit of strong UK action which might encourage other jurisdictions to take similar steps, which would have a beneficial impact on their ability to investigate UK cases involving non-UK incorporated companies. Given the intangible and indirect nature of this benefit, we have not however included this in our assessment below.

89. The OECD reported[45] that: *"Almost every economic crime involves the misuse of corporate entities – money launderers exploit cash-based businesses and other legal vehicles to disguise the source of their illicit gains, bribe-givers and recipients conduct their illicit transactions through bank accounts opened under the names of corporations and foundations, and individuals hide or shield their wealth from tax authorities and other creditors through trusts and partnerships."*

90. They also note that: *"It is extremely difficult to quantify with any precision the extent of misuse of corporate vehicles for illicit purposes. Nonetheless, a number of reports and surveys have concluded that corporate vehicles are used extensively in criminal activities [...] Tax authorities in OECD Member countries have also expressed concern that individuals using corporate entities to hide their assets and activities in order to escape taxes legally due will likely grow. In addition, the United Nations has noted that: "the principal forms of abuse of secrecy have shifted from*

[43] FSA (2011): *Banks' management of high money-laundering risk situations*
[44] HMG (July 2002): *Regulatory Impact Assessment: Disclosure of beneficial ownership of unlisted companies*
[45] OECD (2001): *Behind the Corporate Veil: Using Corporate entities for Illicit Purposes*

individual bank accounts to corporate bank accounts and then to […] other corporate forms that can be purchased readily without even the modest initial and ongoing due diligence that is exercised in the banking sector" […] a critical factor in misusing corporate vehicles is the potential for anonymity."

91. The EU has noted that: *"The absence of public information about the beneficial owner is seen by some stakeholders as hindering the practical implementation of the requirements. […] The European Commission's Internal Security Strategy has also highlighted this issue and suggested, in the light of discussions with its international partners in the Financial Action Task Force, revising the EU Anti-Money Laundering legislation to enhance the transparency of legal persons […].*[46]*"*

92. The FATF recommendations 2012 refer to: *"[a] lack of transparency about the ownership and control of legal persons […] makes those instruments vulnerable to misuse by criminals and terrorists. The FATF has strengthened transparency requirements in these areas. This means requiring that there is reliable information available about the beneficial ownership and control of companies […] Measures to improve transparency, implemented on a global basis, will make it harder for criminals and terrorists to conceal their activities."*

93. Since the opacity of company beneficial ownership facilitates criminals to engage in serious crime such as fraud and terrorism, it follows that increasing transparency could lead to a reduction in the total amount of this detrimental activity committed in society due to both the successful prosecution of those committing the crime and the deterrent effect of penalties introduced (see 'rationale for intervention').

94. This could take the form of a reduced number of crimes and/or a reduction in the average value of a crime. The existence of crime could result in a reduction in economic activity (e.g. agents engage in less economic activity to avoid fraud; and resources are spent on non-productive/inefficient activity, insurance expenditure and costs to the Criminal Justice System, including the police/other criminal investigators).

Total economic cost of fraud

95. On this basis, we have, as set out below, sought to monetise partially the benefits arising from reduced crime through enhanced transparency of company beneficial ownership. It is not possible to monetise fully the benefits to society from a reduction in crime, or the benefits to law enforcement agencies in terms of reduced costs. This is in part because of the way in which they record their case data. Given the huge scale of any corporate investigation and the corresponding myriad evidence, there is no systematic distillation of these data such that we can interrogate the impact of a single factor, such as hidden beneficial ownership. Indeed, a criminal could conceal their identity using a number of, and indeed multiple concurrent, approaches.

96. The crime associated with a lack of transparency of company control, including through hidden beneficial ownership, imposes significant direct costs on society. These costs include the physical, financial and emotional damage to the victim[47]; insurance expenditure; lost output; and costs to the Criminal Justice System, including the police. The economic cost of crime for a full

[46] 2012: REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL on the application of Directive 2005/60/EC on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing

[47] Economic theory would normally dictate that theft, for instance, is a transfer from one individual to another, so is not considered a loss to society. However, given that the transfer is unwanted and moves the stolen item from the legal economy to the illegal economy, following Brand and Price (2000), we consider this part of the costs of crime.

range of offence categories has been estimated by Brand and Price (2000)[48]. We have selected fraud as a key crime on which to focus here; it is a financial crime of the sort that could be facilitated by the use of opaque company ownership structures and Brand and Price's fraud data also encompass money laundering. In pulling out this strand for further analysis, we should bear in mind the breadth of potential criminal activity linked with opaque corporate structures.

97. Below, we estimate the total economic cost of fraud. This figure is then used to give illustrative examples of the potential economic benefits resulting from the crime reduction associated with this policy. Given that law enforcement agencies cannot identify the crime reduction caused by individual policy changes, we have offered illustrative examples to go some way towards estimating the benefits.

98. The estimates Brand and Price use are in turn based on a study by National Economic Research Associates (NERA; 2000). The methodology places a value on the opportunity cost of resources used:

- in anticipation of crime (e.g. insurance[49] or security expenditure);
- as a consequence of crime (e.g. to the victim); and
- as a response to crime (e.g. to the criminal justice system[50]).

99. We have uprated the average cost estimates for inflation to arrive at estimates in 2013 prices, according to standard HMT GDP deflators[51], and removed the cost of benefit fraud which as a conservative step could be considered a subset of fraud less likely to be related to misuse of company structures. This gives us two estimates of the cost per fraud offence of approximately **≈£500** and **≈£1400** in 2013 prices as shown in the table below:

Table 1: The Economic Cost of Fraud – A report from the Home Office and Serious Fraud Office (NERA, 2000)

		1999 Cost (£m)	2013 Cost (£m)
Resource costs	Criminal Justice System (including SFO)	579	776
	Other public sector	412	553
	Private sector	156	209
Transfer costs	Public sector	2682	3595
	Private sector	1377	1845
	SFO	1138	1524
Other misallocation of resources (tax distortion)		1858	2490
Number of offences		7.7m	7.7m

48 Brand and Price (2000): *The economic and social costs of crime*. Home Office Research Study 217. London: Home Office. Although this is not a recent publication it set the standard for robust analysis in this area, and as set out below prices have been adjusted for 2013.

49 In a purely economic sense, when an insurance claim is made, it is a transfer. As such 'insurance expenditure' in our estimates only includes insurance administration costs (i.e. the running costs for insurance companies – staff, ICT, property etc) because without crime these costs would be deployed elsewhere in the economy (see Brand and Price (2000) for more detail). Companies might, for instance, purchase fidelity guarantee insurance to protect against fraud by an employee, or crime protection insurance. The Fraud Advisory Panel currently advises small businesses to consider such products, as part of their advice to reduce the impact of fraud on small and medium sized businesses. *Fraud Facts.* 2009: https://www.fraudadvisorypanel.org/pdf_show_112.pdf

50 The estimated impact on the Criminal Justice System (CJS) is based on the Home Office 'flow and costs model'. The model estimates the long run costs of a criminal flowing through the system from prosecution and trial to probation or imprisonment. This is based on an active sample of resource costs from staff in the CJS and any associated agencies.

51 HMG (December 2013): https://www.gov.uk/government/publications/gdp-deflators-at-market-prices-and-money-gdp-march-2013

	1999 Cost (£m)	2013 Cost (£m)
Total economic cost (excluding transfers, £m) Average cost per offence (£) excluding transfers	3006 ≈400	4028 ≈500
Total economic cost (including transfers, £m) Average cost per offence (£) including transfers	8202 ≈1100	10992 ≈1400

** Average costs have been rounded to the nearest £100 but the original values are used in calculations.*

100. The two estimates differ because the lower figure of ≈£500 excludes transfer costs. A transfer is a redistribution of a good or income from one party to another party such that the recipient's gain exactly offsets the donor's loss and no resources are used. In a pure economic sense, when a criminal steals a victim's property this is a transfer. In reality, however, it is an unwanted transfer, and victims suffer the emotional and physical impact of crime; indeed, the Ministry of Justice *Criminal Justice System Cost-Benefit Framework* considers the victim's losses but not the offender's gains from crime. Including transfer costs gives a figure of ≈£1400 per fraud offence.

101. We consider ≈£500 as our 'best', and most parsimonious estimate, while providing the estimate of ≈£1400 for further context as the cost of a fraud offence. While we cannot directly relate a number or proportion of such offences directly to the use of hidden beneficial ownership, we can estimate, for illustrative purposes, the overall economic cost of fraud, and seek to understand how it might be changed.

102. To arrive at an estimate, we multiplied the average cost of fraud offences by ONS (2013)[52] crime figures. We estimate that there were **1 million fraud offences** across the UK in 2012/13[53].

103. On the basis of 1 million fraud offences being committed in 2012/13 with an average cost of ≈£500[54] we estimate that the total economic cost is **£523m**, of which £496m falls on the public sector[55] and £27m falls on the private sector. This is calculated as follows:

≈£500 x 1million = £523m[56]

Average cost per offence x number of offences

The impact of this policy intervention

104. One might expect the impact of the *Transparency and Trust* package, which contains a series of targeted measures including enhanced transparency of company beneficial ownership,

52 Office for National Statistics (2013): *Crime in England and Wales, year ending June 2013 – Appendix tables*
53 Since the ONS data are only for offences committed in England and Wales and the NERA figures cited in Brand and Price (2000) split all UK recorded offences into those committed in each devolved administration, we applied the same proportional distribution as Brand and Price (91% of fraud offences committed in England and Wales; 8% committed in Scotland; and 1% committed in Northern Ireland) to arrive at an estimate of the total offences committed in the UK. This overall figure of 1 million excludes cheque and credit card fraud and accounts for the number of unreported offences, using the crime multiplier in NERA (2000).
54 To note unit costs are rounded for presentation in the text, with original figures used for calculation to give overall estimates.
55 Public sector costs include costs to the Criminal Justice System, the NHS, Customs & Excise & VAT, Inland Revenue and Local Authorities. The public:private sector cost distribution is calculated based on the distribution in the above table.
56 To note unit costs are rounded for presentation in the text, with original figures used for calculation to give overall estimates.

would impart a deterrent effect on criminal activity. This could potentially be reinforced by a further deterrent effect from additional law enforcement capacity on the basis of greater investigation efficiency if companies are more transparent. This deterrent effect could in turn reduce costs for law enforcement agencies.

105. In terms of wider reductions in costs for law enforcement agencies, enhancing the transparency of company beneficial ownership would remove a layer of complexity in investigations seeking to identify the natural person ultimately owning or controlling a company, resulting in expedited and more efficient processes.

106. As noted above there is no reliable or systematic way of attributing reductions in law enforcement agencies' costs or the consequences directly and exclusively to enhanced transparency of company beneficial ownership. For this reason, the benefits resulting from reduced costs to law enforcement remain non-monetised. We should also note that beneficial ownership reform is only one part of the *Transparency and Trust* package. While it is difficult to predict reliably change in the crime rate related to any one part of the package, we could consider that the overall combined effect, including the deterrent of acting, to implement the comprehensive package, is likely to be greater than the sum of its parts.

The scale of the economic benefits

107. Whilst law enforcement agencies are not in a position to quantify the direct or deterrent benefits that the *Transparency and Trust* package might have on fraud offences, we can offer some illustrative examples of the likely economic benefits associated with reducing crime:

- If the package resulted in a 2% reduction in crime, it would yield economic benefits of £10.5m (2% of £523m).
- If the package resulted in a 5% reduction in crime, it would yield economic benefits of £26.1m (5% of £523m).
- If the package resulted in a 10% reduction in crime, it would yield economic benefits of £52.3m (10% of £523m).

108. For further context, as mentioned, we can use the average cost estimate of ≈£1400, which includes transfers, to give an overall cost of fraud. On this basis, the total cost estimate rises to approximately £1.43bn pa. Of this figure, around £1.16bn falls on the public sector and £270m falls on the private sector. The economic benefit of reducing corporate opacity to reduce this crime would similarly be derived from the reduction in these indicative costs.

109. Of course, feeding in to or stemming from illicit activity associated with companies are a range of organised crime and potentially terrorism offences beyond fraud. As noted in Brand and Price (2000), the crime multiplier associated with organised crime is substantial because it sustains and creates other criminal markets, which impose further costs on society. The recent Home Office analysis which accompanied the launch of the National Crime Agency (Mills et al 2013) highlights that organised crime cost the UK £24bn in 2010/11, with drugs supply, for instance, costing the UK £10.9bn within that total[57]. The Home Office analysis excludes money laundering, which as mentioned above has a significant global impact.

57 Home Office analysis cost estimates presented do not include SOCA costs of preventing and responding to organised crime (Mills et al (2013): *Understanding organised crime: estimating the scale and the social and economic costs*, Home Office, Research Report 73) https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/246390/horr73.pdf Any benefits derived from this policy change cannot be monetised.

110. The economic benefit of reducing corporate opacity could therefore reduce the costs arising from a wide range of criminal activity, and as noted above the impact of the package could be greater than the sum of its parts.

111. The above analysis represents just one potential source of benefits of reducing crime. Subjective wellbeing benefits should also be considered. As Brand and Price (2000) set out, there are a range of potential emotional and physical impacts on victims of crime, which might leave a legacy of problems. Reducing crime based on corporate opacity, including through enhanced transparency of company beneficial ownership, will therefore realise benefits to national well-being, as measured by the National Well-being programme led by ONS[58].

112. Action will also help to develop an environment conducive to economic growth in the UK, and attendant benefits. There is a strong body of evidence highlighting how crime in itself acts as a drag on investment, job creation and ultimately economic growth. For instance, Goulas and Zervoyianni (2013)[59] found that in times of macroeconomic uncertainty, a 10% increase in the crime rate is associated with a reduction in annual GDP per capita growth of 0.49%-0.62%. Although the literature[60] does not directly identify the mechanism through which crime affects growth, it has repeatedly been highlighted that reducing crime will support growth.

113. There are also benefits to reducing crime which accrue not just in the UK but internationally. These are not within scope of the process of assessing the impact of the policy change for these purposes, but are nevertheless important. As various reports set out, illicit flows out of low income countries, particularly in Africa, will often be channelled through company structures. They are extremely significant, and it is often claimed that these countries lose billions of dollars per year through illicit flows. Though almost by definition figures are difficult to derive, the Africa Progress Panel chaired by Kofi Annan[61] highlighted the problem, citing research suggesting that the annual loss to Africa between 2008 and 2010 was $38bn, and that between 1970 and 2008 $1.8 trillion were lost from the continent - with obvious human consequences[62]. Moreover, as the National Organised Crime Strategy (2013) sets out: *"overseas, organised crime undermines good governance and the stability of countries of strategic importance to our national security. Organised crime groups overseas can facilitate or engage in terrorism."* Reducing the potential for misuse of the company structure should therefore derive benefits not only for crime in the UK, but for the UK's international reputation and for its international partners, particularly low income countries.

114. In addition to benefits to individuals through crime reduction, there will also be benefits to regulated entities[63] who will have more ready access to information on beneficial ownership, either through Companies House or through the companies themselves being better able to respond to enquiries. We would therefore anticipate some cost savings here in terms of carrying out due diligence. Similarly for private sector organisations engaged in asset recovery and fraud investigation, they might find their costs of investigation reduced. However we have not been able to determine the magnitude of the cost savings. For example, in discussions between

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58 http://www.ons.gov.uk/ons/guide-method/user-guidance/well-being/index.html This includes measures of the crime rate, happiness, anxiety and mental well-being.

59 Goulas and Zervoyianni (2013): *Economic growth and crime: does uncertainty matter* Applied Economics Letters, Vol 20, issue 5, pp420-427

60 See also Detotto and Paulina (2013): *Does more crime mean fewer jobs and less economic growth?* European Journal of Law and Economics, Vol 36, Issue 1, pp183-207 and Detotto and Otranto (2010*): Does crime affect economic growth.* International Review of Social Sciences, Vol 63, Issue 3, pp330-345.

61 Africa Progress Panel (2013): *Africa Progress Report 2013: Equity in Extractives*

62 Global Financial Integrity and the African Development Bank (2013): *Illicit Financial Flows from Africa: Hidden Resources for Development*

63 Regulated entity refers here to an entity subject to the Money Laundering Regulations 2007 (No. 2157), as defined in Regulation 3. This includes: credit institutions, financial institutions, auditors, insolvency practitioners, external accountants, tax advisors, independent legal professionals, trust or company service providers, estate agents, high value dealers and casinos.

financial institutions and HM Treasury, the former have explained that they are unable to monetise the costs they incur in obtaining beneficial ownership information as separate from the total costs incurred in carrying out AML due diligence. This means it is not possible to estimate the potential cost saving if they were to have a central source of information as a starting point for beneficial ownership due diligence checks.

115. No additional data on costs and benefits were provided though the responses to the formal BIS discussion document. 80% of responses to the questions in the discussion document around beneficial ownership were however positive about changes to the obligations, with some wanting the proposals to go further – in terms of the scope and nature of any new requirements - than outlined here. Benefits mentioned included: reducing tax evasion, corruption and money laundering; lowering the costs to regulated entities' in terms of conducting due diligence; supporting developing countries in their efforts to tackle the misuse of companies and tax evasion; increasing the UK's integrity; deterring criminals from operating in the UK; reducing the UK's cost of capital; and providing more information about who does business with whom.

116. In summary, **there is little quantified data about the benefits from this policy proposal**. However, it could be expected that: law enforcement agencies would experience increased efficiency; regulated entities might experience reduced costs; there could be reduced criminal activity and from this efficiency and welfare gains to the economy; and potentially a non-negative impact on economic growth.

B2. Benefits to companies and individuals from corporate transparency supporting the business environment

117. As outlined in the 'rationale for intervention' section, greater transparency of company beneficial ownership will make it easier for those who engage with a company to identify with whom they are actually dealing; and for company shareholders to hold the company to account.

118. For example, in the representative company survey, whilst 60% of companies surveyed indicated that there were no benefits to them from changes to the beneficial ownership requirements, 10% indicated that it would ensure they know with whom they are doing business. Other benefits cited included increasing trust and confidence in their organisation, creating a level playing field, exposing companies that are breaking the law and improving their own peace of mind.

119. Economic theory suggests that this increase in transparency is likely to reduce information asymmetry and increase trust, and therefore increase economic activity including trade and investment (see 'rationale for intervention' section). Empirical evidence in this area, whilst informative, relates to the general relationship, observed across the economy, rather than beneficial ownership specifically.

120. Ultimately, enhancing trust in the business environment serves to "grease the wheels" of economic activity and facilitate economic growth. Greater transparency is associated in the literature with greater investor confidence, alongside trust in companies and between companies. This enables economic transactions to go ahead more readily, since, for instance, a buyer will not be discouraged or delayed by a lack of transparency and trust in a seller, which enables them safely to simplify the contracting process between them[64]. Therefore increased corporate

[64] The importance of trust in economic transactions is highlighted in Fukuyama, F. (1996): *Trust the social virtues and the creation of property*

transparency can increase economic growth through the mechanism of increasing trust and reducing transaction costs.

121. A theoretical framework connecting transaction costs with trust was set out by Bromiley and Cummings (1995) who described a typical agency problem, between a shareholder (principal) who depends on the actions of the company board (agent). They explained, drawing on earlier findings, how a lack of trust can feed into higher transaction costs[65]. This agency problem and the associated complexity related to trust can impact on transaction costs in other settings. Empirically this has received support from Dyer and Chu (2003)[66] who investigated the relationship between 344 buyers and suppliers in the automotive industry of the USA, Japan and Korea. Dyer and Cho concluded that transaction costs[67] were five times higher for the least trusted supplier.

122. There is also a known link between overall economic growth and trust[68], with the literature commonly identifying a significant positive relationship between the two. This emerges because trust motivates investment, innovation and more broadly entrepreneurship[69]. To test the hypothesis that trust reduces transaction costs and therefore enhances growth at a national level, the empirical literature commonly analyses cross-country samples to assess how far countries with higher levels of trust have a higher rate of economic growth. Knack and Keefer (1996)[70] initiated this strand of the literature, finding that a 10 percentage point increase in trust, as measured by the World Values Survey (WVS), is associated with a 0.8 percentage point increase in growth. Zak and Knack (2001)[71] later extended this analysis by adding 12 countries to the dataset - again the relationship between trust and economic growth was significant and positive and a 10 percentage point increase in trust was associated with a 0.7 percentage point increase in growth.

123. The literature has built upon the two seminal papers by Knack and Keefer (1996) and Zak and Knack (2001) by testing their robustness and re-analysing the data. Beugelsdijk et al (2004)[72] find that the Zak and Knack (2001) study had highly robust trust coefficients in terms of significance and magnitude. However, they argued that the relative importance of trust in the study is somewhat affected by which countries are included in the sample and the factors that the regression controls for. More recently Horváth (2013)[73], however, found interpersonal trust to be a "*robust determinant of long-term economic development*" in a study of 50 countries. Indeed, Horváth disagreed with the findings of Beugelsdijk et al (2004) that the link between trust and growth is sensitive to the factors included in the model.

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65 Bromiley, P. & Cummings, L.L. (1995): *Transactions costs in organizations with trust.* Research on Negotiations in Organizations, Vol. 5: 219–47, set up the theoretical framework, which connected transaction costs with trust. This was based on the findings of Williamson O.E. (1985): *The Economic Institutions of Capitalism* which formally founded the New Institutional school of economics. However, the literature is somewhat ambiguous as to the strength of the link between trust and transaction costs.

66 Dyer J.H. and Chu W. (2003): *The role of trustworthiness in reducing transaction costs and improving performance.* Organisation Science, vol. 14 no 1, pp57-68

67 North, D.C. (1990): *Institutions, institutional change and economic performance*, defines transaction costs as "*the cost of measuring the valuable attributes of what is being exchanged and the costs of protecting rights and policing and enforcing agreements.*" Transaction costs come in the form of searching for a contract and relevant information; bargaining and decision making relating to that contract; and policing and enforcing the contract.

68 The literature commonly considers trust in a general sense rather than specifically looking at trust in the business environment. A frequently used source is the World Values Survey (WVS). This is a cross-country social survey of beliefs and values, which *asks 'do you think people can generally be trusted'.* Although the WVS is not directly related to the level of trust in the business environment, as noted by Beugelsdijk (2006) it is strongly correlated with the effectiveness of institutions, which includes industry/business as an institution. We can therefore expect trust to be a good proxy more specifically for trust in the business environment.

69 However, the literature must carefully control for reverse causality, i.e. how far high growth countries are generally more trusting.

70 Stephen Knack and Philip Keefer (1996): *Does social capital have an economic payoff?: A cross-country investigation.* The Quarterly Journal of Economics, 112(4), pp. 1251

71 Zak, P.J. and Knack, S. (2001): *Trust and growth*, Economic Journal, 111, 295–321.

72 Beugelsdijk, S. de Groot, H.L.F. & van Schaik, A, (2002): *Trust and Economic Growth: A robustness analysis*, Oxford Economic Papers 56 (2004), 118–134

73 Horváth, R. (2013): D*oes trust promote growth?* Journal of Comparative Economics, Elsevier, vol. 41(3), pages 777-788.

124. Analysis of US States by Dincer and Uslaner (2010)[74] found a similar (though slightly weaker) relationship between trust and growth – a 10 percentage point increase in trust being associated with a 0.5 percentage point increase in the growth rate. This highlights that the relationship still exists in developed countries or jurisdictions where the rule of law is well established (where one might otherwise have expected it to be restricted to jurisdictions with weaker institutional infrastructure and greater reliance on knowing and trusting business partners).

125. The relationship between growth and trust is therefore a developing strand in the literature and there are some continuing points of debate around the data used. The empirical studies are often reliant on the WVS, which asks the general question: "*do you think people can be trusted?".* Comparing responses over time, as Beugelsdijk (2006)[75] comments, might indicate more of a change in a population's honesty, attitudes or information rather than their behaviour. However, there are few other international measures for trust, which in itself is challenging to measure.

126. The literature does not generally analyse the mechanisms through which trust affects growth. As noted by Dincer and Uslaner (2010), one might expect trust to affect growth via the main growth drivers. To elaborate, one can envisage that individuals in countries with low levels of trust might be more hesitant in engaging in entrepreneurial activity, for fear of protecting their contractual rights, and a lack of innovation and/or investment will certainly impede growth.

127. Two notable exceptions are Bjørnskov (2012)[76] and Botazzi et al (2010)[77], which both examine mechanisms through which trust influences growth. Using cross-country data, Bjørnskov (2012) shows that a lack of trust limits the level of schooling, which in turn limits the investment rate and ultimately economic growth. Botazzi et al (2010) identify the strength of the relationship between trust and investment decisions in European venture capital markets. The theoretical mechanism identified by Botazzi is also similar to that found by Guiso et al (2008)[78], who look at stock market participation. Essentially, trust has an impact on an investor's perception of brokers and intermediaries, and a lack of trust thereby raises transaction costs and reduces the investment rate.

128. In and of itself, trust is not likely to drive growth, but it certainly feeds into stability and certain economic systems which are key to economic activity. In terms of its relative importance as a factor underpinning growth, Whiteley (2000)[79] found evidence suggesting that social capital, defined as the extent to which people are prepared to co-operate based on interpersonal trust, has a significant impact on growth, at least as strong as education or human capital.

129. By increasing corporate transparency, including through the creation of a central registry of company beneficial ownership information, benefits to trust, and therefore the business environment and potentially economic growth, should be realised.

Costs

130. The cost estimates below are based on a range of evidence drawing in large part from a survey of companies undertaken by IFF Research (2013; see **Annex A**)[80]. The costs identified

74 Dincer and Uslaner (2010): *Trust and Growth* Public Choice (2010) 142: 59–67
75 Beugelsdijk, S. (2006): *A note on the theory and measurement of trust in explaining differences in economic growth.* Cambridge Journal of Economics, 30, 371–387
76 Bjørnskov (2012): *How Does Social Trust Affect Economic Growth?* Southern Economic Journal, Working Paper 06-2
77 Botazzi, L., Da Rin, M. and Hellman, T. (2010*): The importance of trust for investment* NBER Working Papers 16923
78 Guiso, L, Sapienza, P. and Zingales, L. (2008): *Trusting the Stock Market* The Journal of Finance, Vol 63, Issue 6, pp2557-2600
79 Whiteley, P. (2000): *Economic Growth and Social Capital*, Political Studies 48, 443-466
80 IFF Research (2013): *Transparency and Trust Company Survey* – Forthcoming

through the survey have been processed before being applied to wider populations of companies to arrive at estimates of the overall impact of the policy. This processing has included the removal of values that could make the dataset less robust, including implausible 'zero' values and very high values (again, see **Annex A**)[81].

Corporate entities in scope

131. It is proposed that all companies incorporated in the UK and UK Limited Liability Partnerships (LLPs) will be in scope of the proposals, with the exception of companies listed on a regulated market[82]. Additional types of corporate entity may ultimately be placed in or out of scope of reform and so additional legislative and policy changes may be required (see **Annex B**).

132. In order to identify the number of companies in scope we have used the FAME company database (which uses, amongst other sources, Companies House data). This is because, unlike Companies House data, the FAME database allows us to identify company size by turnover, assets and employees.

133. Using the FAME database there are **3.19m UK companies**[83]. This figure will include active and dormant companies, and companies in the process of being dissolved. Of these **3.13m are small or micro companies**. Companies House register statistics show that there are around 59,000 LLPs on the 'LLP Total Register'[84].

134. It is expected that the costs to companies will depend on the company's number of shareholders but also its size and structure. According to FAME data, out of the 3.19m UK companies, there are **2.96m with less than four shareholders**. It is likely that for these companies, the overall costs associated with identifying and reporting beneficial ownership, would be lower than for companies with more shareholders.

135. In addition, **3.00m companies have a simple ownership structure of one or fewer layers of ownership** (i.e. where the legal owner is the beneficial owner); **100,000 have two or three layers** (i.e. where the legal owner holds shares on behalf of the beneficial owner) and **78,000 have four or more layers, or some foreign ownership**. *Ex ante* we also expect those with more layers/more complexity of ownership to face the greatest costs in identifying their beneficial owners.

136. However, the proposals, to a greater or lesser extent, will impact on all companies in scope regardless of size or complexity of ownership.

137. Currently we anticipate that we would at least exempt UK companies listed on a regulated market. We may also ultimately exempt their wholly owned subsidiaries, and potentially also companies listed on prescribed markets such as AIM. This is because these companies, or their parent, already disclose ownership information. It is likely that we would require subsidiary companies to name their parent in order to 'claim' the exemption. These variables are considered further at **Annex B**.

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[81] Please note: costs have been rounded in this section to avoid spurious accuracy.

[82] See Regulation 2 of the Money Laundering Regulations 2007 (No. 2157)

[83] Company population estimates were extracted from the FAME database (Bureau Van Dijk Electronic Publishing, 2013) on 13 December 2013. This figure includes Limited Liability Partnerships.

[84] Companies House (November 2013): *Companies Register Statistics for November 2013*

138. Given the number of regulated markets worldwide, the exact number of UK companies listed on these regulated markets is unknown, but various sources have been used to provide an indication:

- According to the **FAME** database there are around **1,712** UK companies publicly listed on main world stock exchanges[85]; of which there are around **71,000** wholly owned subsidiaries.
- Information from **Companies House** suggests that there are approximately **4,733** UK companies with shares admitted to trading (including on non-regulated markets such as AIM).

139. We expect therefore that, given the information available, the number of companies exempted would be in the range of **2,000 to 5,000**, with total subsidiaries of at least **71,000**.

C1. Public sector costs

One-off costs

a.1. IT development

140. Costs to Government will involve increased costs to Companies House in setting up and administering the register.

141. For the purpose of the model being considered in this Impact Assessment, only the costs of receiving returns once a year have been considered. The higher costs to Companies House from additional procedures are included in the Sensitivity Analysis at **Annex B**.

142. Companies House has indicated that they will experience a one-off cost ranging from **£39k- £97.5k** for IT development to set up the registry. This will involve collecting and storing beneficial ownership data in new fields and tables in the existing system. If the information is updated in the context of the annual return, it is estimated that it will cost £39k. This has been established as the lower case. Making the information publicly accessible would cost a further £19.5k. Companies House also adds £39k contingency to the range. These costs only account for development and do not include any other business costs such as training or communication. If there is insufficient internal development resource external resource may be required which would cost significantly more.

143. The cost of alternate policy options is considered at **Annex B**.

144. The outcome of the consultation on *Company Filing Requirements*, specifically proposals for the future of the annual return, will also impact the cost of beneficial ownership reform. The costs of a policy change to the annual return will be considered separately and reflected in the Final Stage Impact Assessment for this policy as required.

a.2. Communication and publication costs

145. Companies House will issue communications to all companies to ensure they are fully aware of the regulatory changes associated with beneficial ownership disclosure and indeed the rest of the *Transparency and Trust* package.

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[85] Australian Securities Exchange, Boerse Berlin, Boerse Frankfurt, Bolsa de Madrid, Bursa Malaysia, Channel Islands Stock Exchange, Euronext Amsterdam, Euronext Brussels, Euronext Paris, GXG Regulated Market, Hong Kong Stock Exchange, ICAP Securities & Derivatives Exchange (ISDX), Irish Stock Exchange, Johannesburg Stock Exchange, London Stock Exchange, London Stock Exchange (SEAQ), NASDAQ Dubai, NASDAQ National Market, Nasdaq OMX – Helsinki, Nasdaq OMX – Stockholm, New York Stock Exchange, Norvegian OTC, Oslo Bors, Oslo Bors, OTC Bulletin Board, OTC Pink Market, Other OTC Market, USA, Swiss Exchange, Tokyo Stock Exchange, Toronto Stock Exchange, TSX Venture Exchange, Warsaw Stock Exchange, Wiener Boerse, XETRA

146. It is likely that Companies House would use a wide range of cost effective and targeted communications to companies such as including inserts with standard reminders. Companies House has indicated that the anticipated costs of sending an insert on *Transparency and Trust* reforms to 3.19m companies is around **£23k.**

147. This would be supplemented by website notices and guidance; FAQs; and social media information. Engagement with company agents and representatives through Focus Groups and events would also be helpful in ensuring that the requirements are understood. As the policy is further refined we will be able to develop handling plans and therefore further refine the cost estimates.

148. Moreover, communication of each part of the *Transparency and Trust* package and of the changes derived from the *Company Filing Requirements* consultation could be delivered, as appropriate, in concert, and the costs of communicating each individual measure thereby reduced. So, dividing the communication costs between the *Transparency and Trust* measures covering the registry of company beneficial ownership and opaque arrangements involving directors[86], the costs for communicating each policy measure would be **£11.5k**.

149. **The overall one-off costs to the public sector are estimated to be £80k (11.5k + mid-point between £39k and £98k) with a range of £51k and £110k.**

Ongoing costs

a.3. Staff costs to support the registry

150. Assuming beneficial ownership information is submitted at incorporation and in the context of the annual return there will be very little additional cost in terms of staff resources (relative to total Companies House costs) as 98% of incorporations and returns are handled electronically.

151. There will however be ongoing staff costs of **£220k** pa to support the closed system for beneficial owners who are deemed at risk. This is based on the current costs of seven people administrating the (closed) usual residential address system for company directors. If Companies House were to set up a similar system for beneficial ownership, they estimate that the costs would be roughly the same.

152. **Total Net Present Value ongoing costs to the public sector are therefore expected to be £1.9m over 10 years[87].**

153. This Impact Assessment assumes 100% compliance, thus court costs will be zero. However, where this turns out not to be the case, as the policy will introduce new criminal sanctions there may be additional costs for the criminal justice system (Justice Impact Test provided separately and summarised below).

C2. Private business costs

[86] The other main part of the *Transparency and Trust* package and one of the Impact Assessments submitted in parallel refers to bearer shares, which requires the handling of a much smaller and known group of specific companies.

[87] 10 years is the expected life of the policy and the NPV uses standard Green Book discount rates.

154. One of the policy drivers for beneficial ownership reform is the opacity associated with company ownership – the fact we do not know who really owns and controls UK companies. There are therefore methodological challenges associated with estimating the cost to business with a high degree of certainty because we do not know how many beneficial owners of UK companies there are, or to what extent UK companies already know and hold this information. For that reason, we have triangulated several sources of evidence to estimate the likely costs of the policy option.

155. Responses to the *Transparency and Trust* discussion document were mixed with respect to the costs to business from this reform. 30 of the 199 responses which set out views on the costs and benefits indicated that the costs would be minimal; a further 16 indicated that costs would be burdensome.

156. A 2013 report for Global Witness by J Howell & Co Ltd[88] estimated the costs to be a £24m one-off cost plus £2.3m ongoing costs. These equated to less than £10 one-off cost and less than £1 annual costs per company.

157. We have considered this report, and its findings, carefully. However, the approach is largely based on a probabilistic approach, rather than direct engagement with the business community. The assumptions used may not therefore reflect the actual cost to businesses (e.g. the cost of collating and processing the relevant information). In addition, the research does not consider familiarisation costs, which we would expect to form a significant proportion of the total cost to - at least some - businesses.

158. BIS also undertook a non-representative company survey as part of the consultation process. Only 32 responses were received. However, these showed that around half of respondents said that the cost of gathering the information would be zero or negligible but other estimates ranged from £100 pa to £50k pa and 5% of existing costs.

159. A sample of published Impact Assessments and the Companies Act 2006 evaluation were analysed but provided few or no relevant cost estimates for this proposal.

160. Also, in 2007, PWC were commissioned to produce an Administrative Burdens Measurement Exercise. This exercise estimated administrative burden (compliance costs) of regulations across a number of policy areas including business environment.

161. PWC estimated the cost of completing, signing and returning Companies House form 692b (for the return of alteration in the directors or secretary of an overseas company or in their particulars)**[89]** to be £10.73 per company, which uprated to 2013 prices is £12.39.

162. The different source of information gathered and the results are presented in the table below:

[88] John Howell & Co. Ltd. (April 2013): *Costs of Beneficial Ownership Declarations*

[89] The form deals with any alteration made in the Directors or secretary of an overseas company or the particulars contained in the list of the directors and secretary

Table 2: Comparison of data sources

Data source	One-off costs	Ongoing costs
Consultation responses (199 responses)	30 responses – minimal costs, 16 responses - burdensome	
Global Witness report	£10 per company	£1 per company per year
Non-representative consultation (32 responses)	Range between £0 and £50,000	
PWC report		£12.39 per company per year

163. Given the limited, but wide-ranging estimates available on the costs, BIS undertook a representative survey of companies (see **Annex A** for information on the methodology used). The sample reflected companies which were small/micro and ones which were medium/large and also the complexity of their ownership structure.

164. The questions covered were: the familiarisation costs of the proposals; the initial costs of identifying and collecting the details of the beneficial owner; the collation and storage of the data; sending returns to Companies House; and, if they own another company, the cost of responding to a request for information about their beneficial ownership.

165. The total costs figures were calculated based on estimates for the **number of hours** it would take particular employees to comply with the proposals multiplied by the **hourly wage rates** taken from the Annual Survey of Hours and Earnings (as set out in **Annex A**). Estimates of additional cost were also provided.

166. Survey responses were gathered by size of companies and by complexity of the ownership structure (that is: small simple; large simple; small reasonably complex; large reasonably complex; small complex; large complex).

167. In-depth analysis of the survey data revealed a number of issues with the methodology (more detail is provided at **Annex A**). In particular a number of respondents estimated very high costs in each of the cells, sometimes in contrast to the majority who estimated zero costs. We therefore adjusted the results to arrive at more reliable cost estimates.

168. In summary we made three types of adjustment to the data:

- we removed extreme values for each of the responses;
- we removed any responses with zero costs; and
- we removed any additional costs and only considered staff costs.

169. The aim of adjustments (a) and (b) is to remove any non-plausible results. That is, extreme values or zero costs. For the latter an assumption is made that the proposal will have a cost to all businesses even if it is related to reading and understanding the new regulations.

170. The aim of adjustment (c) is to remove any costs for which we do not yet have enough information to assess. This approach aims to ensure any data considered is as robust as it can be.

171. **Annex A** provides further information on each of the adjustments. The results of this process are given below.

Table 3: Breakdown of costs to businesses

	Adjusted mean £
One-off costs	
Familiarisation costs	52
Identification and collection (50% of costs recorded by the survey)*	9
Collation, processing and storage	10
Sub – total average one-off cost	***70***
Responding to request (only for parent companies)	14
Ongoing costs	
Annually update own records**	16
Report to Companies House annually***	9

**The results for this cost is halved (and is a best estimate) as there will be a shared obligation for these actions falling on both companies and beneficial owners (see below for further explanation).*
***The policy is ultimately likely to require companies to update their own records as they are made aware of changes by the beneficial owner. They may also be required to themselves carry out an annual update to their records. The survey was based on the latter only.*
****It is not clear whether respondents costed this in the context of the existing annual return process or as a new, separate process. The latter may be expected to have a higher cost than the former; this may therefore have impacted the responses provided. We anticipate that any annual report to Companies House would be required alongside other annual updates.*

172. The table gives the average cost per company of the various actions they will be required to take as a result of the policy. The 'sub-total' row gives the total average one-off cost that will be imposed on all companies. The 'responding to requests' row is a one-off cost that will only apply to a limited number of companies (see below).

One-off costs

173. Based on the information above, the one-off costs to companies for **familiarisation, identification of beneficial owners, collection of data and collation and storage of data**, i.e. the initial set up costs; this gives a cost estimate of **£225m** for all companies.

174. These costs are derived as follows: (£52+£9+£10)*3.19m, where 3.19m is taken as the total number of UK companies. Sensitivity analysis around this figure (using 20% increase and decrease in costs) estimate gives a range of **£180m** to **£270m**.

175. The cost to companies of identifying and collating data on beneficial owners has been reduced from the initial survey results given that a disclosure obligation will also be placed on the beneficial owner to inform the company of their interest in the company. This means that the company itself will only be required to identify significant beneficial ownership (e.g. to identify the beneficial owner in cases where more than 25% of shares are held by one shareholder); not all beneficial owners. It is assumed that the costs will fall by 25%-75% with a best estimate of 50%.

176. In addition to these costs there is also the cost of processing and collecting the data and responding to requests from other companies.

177. The FAME database indicates that there are around 130,000 UK companies that have subsidiaries, i.e. 130,000 'parent companies'. These parent companies might need to be approached by their subsidiaries in the process of determining beneficial ownership. The adjusted mean from the survey of the costs of responding to requests for information is £14 per company. Thus the best estimate cost of this element of the proposal is **£2m**.

178. As the policy is further developed we will consider whether there will be any additional costs to companies through notification of the policy change to shareholders or beneficial owners. We would anticipate that any such costs would be minimal if this can be done by way of amendment to normal company communications.

179. **The overall one-off costs are therefore estimated to be £226m, within a range of £181m to £272m.**

Ongoing costs

180. Costs on an ongoing basis are also incurred. Here we assume that notification by the company to Companies House will be required on an annual basis; and that beneficial owners will be required to inform the company of changes as they occur (with the company then updating the records they hold as that information is received). As noted under the description of policy Option 1, we are considering whether updates by the company to Companies House will be submitted on an annual basis or as they occur. This is considered further in the Sensitivity Analysis at **Annex B**.

181. We would not expect the names of the beneficial owners to change while they hold the interest in the company (apart from occasionally, potentially on marriage – less than 1% of women per year[90]). Thus, the updates companies are likely to receive on an ongoing basis are likely to relate to changes of address or transfers of ownership.

182. On average the ONS's publication *Social Trends* indicates that people move about every 10 years (probability of 1/10). Pitchbook and Grant Thornton's *Private Equity Exits* reports indicate that on average non-trade equities (in the US) are held for 4.8 years (i.e. would change twice in 10 years – probability of 2/10). Assuming that the UK holding periods are similar to those in the US, a company with three beneficial owners (each with over 25% of shares) might have to change the details they hold on average once a year (i.e. 1/10 (probability of moving every 10 years) + 2/10 (probability of changing non-trade equities in 10 years) for each beneficial owner multiplied by three owners). In fact 84% of the survey respondents indicated that the details would never change in a year: on this basis the above calculation of once a year might be an overestimate. However, for some companies the changes might occur more frequently – for example, for UK companies listed on AIM (of which there are around 750). However we have no information on length of holdings for such companies (especially where holdings of 25% or more are concerned).

183. From the above Table 3, the companies' **annual update of beneficial ownership data and the annual returns to Companies House** are estimated to cost **£78m** ((£15.7+£8.7)*3.19) reflecting the adjusted mean, with a range of **£62m to £93m** for a plus or minus 20% adjustment. However, this may not take into account that the majority of changes would be driven by notification from the beneficial owner, not positive identification by the company. So in many

90 ONS (2011): *Marriages in England and Wales (provisional)*, The Guardian, 7th March 2013

cases, this will be a purely administrative task by the company which can be incorporated into their existing processes. We might therefore expect this cost to be much lower.

184. **The overall Net Present Value of on-going costs expected to companies equals £671m over a 10 year period[91].**

Caveats with the survey results

185. As mentioned above, concerns have been raised around the accuracy and robustness of the original survey results where both one-off and ongoing costs derived were significantly above what was expected at the beginning of the policy development process, and above previous cost estimates[92] - in particular familiarisation costs.

186. **Annex A** provides detail on these concerns and how results have been adjusted for the purpose of this Impact Assessment. Given that this is a Consultation Stage Impact Assessment and that the adjustments are only interim, the costs presented in this Impact Assessment should only be considered as **preliminary.** Further work will be undertaken between now and the publication of the Final Stage Impact Assessment to gain a better understanding of the costs.

C3. Individuals

187. As outlined above in relation to costs to business, it is not possible to estimate the cost to individuals with a high degree of certainty because we do not know how many beneficial owners of UK companies there are; nor do we know how much it might cost them to become familiar with their obligations; to respond to a request for data; or to provide the data proactively. We assume that their details (address and interest in the company) would not change more than once every three years on average (see above), though this might be greater for some companies, for example those listed on AIM where trading might increase the frequency of changing shareholdings. The hourly value of an individual's time, uprated to 2013 prices is **£6.20** (http://www.dft.gov.uk/webtag/documents/expert/pdf/u3_5_6-vot-op-cost-120723.pdf): the ASHE median wage per hour (up-rated to 2013 and including non-wage costs) for all employees is £15.40[93].

188. For the purpose of this Impact Assessment we are working on the assumption that each company will have at least one beneficial owner (i.e. one individual who ultimately owns or controls the company). So we might expect the number of affected individuals to be at least 3.19m (although some individuals will have a beneficial interest in more than one company, meaning that the actual number of individuals could in fact be less than 3.19m, they would nevertheless have to carry out the necessary actions for each company in which they had an interest).

189. In reality, the number of affected individuals will likely be more, as some companies will have more than one beneficial owner. But some of these individuals may be the legal owner or director of the company; and so the required information on beneficial ownership may already be held by the company. In such cases, the cost to the individual should be negligible. As an indication, data from Companies House shows that the total number of companies with a single shareholder (legal owner) is 1.5m, of which 1.2m are estimated to be natural persons and 0.3m

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[91] 10 years is the expected life of the policy and the NPV uses standard Green Book compliant inflation and discount rates.
[92] For example, the analysis conducted by John Howell & Co. Ltd. (April 2013): *Costs of Beneficial Ownership Declarations.*
[93] Annual Survey of Hours and Earnings (ONS, 2012) – up-rated by 17.8% for non-wage costs.

legal persons (i.e. other companies). Of the shareholders that are natural persons, we would expect many to be the sole beneficial owner of the company.

190. Some individuals may also incur a cost resulting from their loss of anonymity - e.g. those investing in companies which others deem unacceptable. However there is a lack of evidence in the literature about the economic benefits from anonymity. Therefore it is not possible to quantify this cost. It is of note that in cases where the individual might be at risk as a result of public disclosure, we would propose to protect their information from public disclosure. We do not therefore anticipate any cost in terms of an impact on individuals' well-being through lost anonymity.

Option 2 - Government-led campaign to encourage enhanced transparency of company ownership*: *Non-regulatory option

Benefits

191. The benefits of Option 2 are expected to be associated with increased economic activity arising from increased transparency.

B1. Benefits to Government, individuals and business of a reduction in illicit activities

192. Unlike under Option 1, we would not expect to see benefits associated with a reduction in illicit activity.

193. There are non-regulatory techniques for crime prevention and reduction, as outlined in the Home Office's *Serious and Organised Crime Strategy*[94]. For example, education and communications strategies raise awareness of the impacts of serious and organised crime.

194. However, a key element of that strategy relates to: "*prosecuting and disrupting serious and organised crime"*. This necessitates a regulatory approach – regulatory requirements to make it more difficult for criminals to operate and regulatory sanctions to allow prosecution and disrupt criminal activity (e.g. by imprisoning offenders, thereby preventing further criminal activity). In the context of corporate transparency, law enforcement agencies have endorsed the importance of a regulatory approach - highlighting the potential to deter and disrupt criminal activity.

195. We therefore anticipate that a non-regulatory approach would not contribute to reduced levels of crime as companies engaged in criminal activity would simply opt not to disclose this information. Although law enforcement agencies would continue to use existing mechanisms to obtain beneficial ownership information in such cases, Option 2 would not assist them in so doing. And even if enforcement agencies were provided with additional resource to carry out such investigations, this does not address the underlying problem of corporate opacity. A necessary corollary of a non-regulatory approach might therefore be a continued need for increased levels of public sector spending. But this still might not ultimately deliver any more successful outcomes in terms of the identification and prosecution of the individuals really responsible for the crime.

196. It is possible that enhanced transparency – albeit voluntary - may ultimately deter some individuals who would otherwise have chosen to conduct illicit activity through incorporating a

[94] Home Office (2013): *Serious and Organised Crime Strategy*

company in the UK. However, it is not possible to estimate this impact – particularly as it would likely be contingent, at least in part, on the action other jurisdictions take in this sphere (i.e. whether they do more or less than the UK).

197. Also if other jurisdictions do perceive that UK action taken is weak, they may be less willing to collaborate with the UK in terms of cross-border investigations. It is not possible to quantify the reduction in potential benefits to the UK under Option 2 compared to Option 1 as a result of this. However, we might anticipate that it would reduce the benefits to be derived from a collective and collaborative international approach to addressing the misuse of companies – meaning that UK citizens and enforcement agencies would continue to be impacted by crime conducted by overseas companies in the UK.

198. By extension, we would not therefore expect to see any benefits associated with a reduction in criminal activity to individuals and business under Option 2.

B2. Benefits to companies and individuals from corporate transparency supporting the business environment

199. As outlined under Option 1, greater transparency of company beneficial ownership will make it easier for external parties to determine the individuals who own and control the company and for shareholders to hold the company to account; contributing to enhanced trust in the business environment and facilitating economic growth.

200. A non-regulatory approach may contribute towards this objective. There is, for example, evidence as to the positive impact that non-regulatory measures, based on behavioural science, can have on instances of fraud, error and debt[95]. We might expect that companies would be incentivised to comply based on their competitors adopting a more transparent approach; and that ultimately, those companies that do not comply might be those that are more likely to have something to hide.

201. In such cases, external parties might become less likely to engage with the company – putting those companies at a competitive disadvantage and making it increasingly difficult for them to do business. However, we would caveat this by noting that companies engaged in illicit activities may not engage with the legitimate economy at all. Any potential benefit may therefore be limited.

202. In addition, under this voluntary approach, we would expect the benefits of enhanced transparency to be generally less widespread than under a mandatory approach (i.e. Option 1). This is because, as addressed in the 'rationale for intervention' section, even though information about the commercial advantages of corporate transparency exists, companies may be unaware of this or under-estimate the benefits (relative to their assessment of the costs involved). A voluntary campaign seems unlikely therefore to be the most effective way to ensure that the benefits of enhanced corporate transparency are universally realised.

203. Finally, under a non-regulatory approach the UK will not meet its G8 commitments and will likely not be compliant with FATF standards. This may impact the UK's reputation as a clean and trusted place to do business and invest, which could have an adverse impact on economic activity.

[95] Cabinet Office (February 2012): *Applying behavioural insights to reduce fraud, error and debt:* https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/60539/BIT_FraudErrorDebt_accessible.pdf

Costs

Corporate entities in scope

204. The entities in scope of Option 2 could potentially be wider than under Option 1 as companies that we would exempt under a mandatory approach might choose to provide information under a voluntary approach. However, for the purpose of this analysis we assume that the number of entities in scope is the same.

C1. Public sector costs

205. Under a voluntary disclosure approach, Companies House would incur much the same IT costs as under Option 1 because they do not currently capture any of this data. They would therefore need to amend their existing systems to capture beneficial ownership information and make it available. Companies might have a choice whether to provide this information, for example, in their annual return or by a separate notice. It is assumed that there would be no ongoing costs as there would be no 'at risk' beneficial owners identified; and therefore no closed beneficial ownership register to administer. Thus the one-off costs would be **£69k** (with a range of £39k to £98k).

206. Companies House operates as a Trading Fund and would need to recover the costs of those services. For statutory activities they do this by charging fees. If the information is not statutory information they would not be able to recover its costs through the fees they collect from companies.

207. There would be further costs to the public sector associated with promoting the voluntary approach, for example, communications campaigns and business engagement. Whilst we do not have detailed information on the costs of a communication campaign specifically on this issue, the 2013/14 campaign to encourage more SMEs to access the Regional Growth Fund (a direct access fund to stimulate growth), may be used as a reasonable proxy. The aim of the campaign was to raise awareness of the fund and encourage businesses to access it to help create/protect jobs in the private sector. It was a light-medium weight campaign which used a combination of regional radio partnerships, digital advertising, local PR, email marketing and paid-for internet search terms. These are all standard marketing channels for Government communications to business. The cost of the campaign was **£400k.**

C2. Private business and individual costs

208. Option 2 would provide no new regulatory costs to business or individuals. Companies deciding to disclose the information would incur some costs, but this would happen on a voluntary basis and therefore it is expected that this will only happen when the benefits to the company outweigh the costs.

G. Rationale and evidence that justify the level of analysis used in the Impact Assessment (proportionality approach)

209. We believe that the analytical approach taken in this Impact Assessment is proportionate. The table below sets out the data we would have required in order to have obtained a full monetised analysis; and why we were not able to include this.

210. The *Transparency and Trust* package was started with initially very limited evidence, primarily because the criminal nature of the problem we are targeting makes data collection challenging. Moreover, the breadth of the areas addressed in the package has not been studied in detail before.

211. Prior to the launch of the *Transparency and Trust* paper we carried out a number of discussions with industry, NGOs and regulated bodies; both during and after the G8 process. We also ran an online non-representative survey to gain initial cost estimates, and considered previous research in this area (for example, the 2002 HMG Regulatory Impact Assessment on *Disclosure of beneficial ownership of unlisted companies*). During the consultation on the *Transparency and Trust* paper, which fed into the evidence base underlying this Impact Assessment, we have:

- consulted with the Economic and Social Research Council;
- consulted with Companies House;
- undertaken a full literature review;
- opened an online survey accessible by the general public;
- consulted with business, regulated entities and law enforcement agencies in a series of focus groups and one-to-ones; and
- commissioned a representative company survey through IFF Research (see **Annex A**).

212. After the publication of the *Transparency and Trust* discussion paper, we undertook a series of focus groups as well as an online survey to inform the content of our proposed policies. Indeed, the evidence gathered from stakeholders has and will continue to play a key role in our ability to determine which policy options will have the desired effect, without unintended consequences or imposing unnecessary burdens on business.

213. In terms of examining the benefits of corporate transparency for the business environment and those operating within it, Companies House and FAME data first enabled us to identify the population of companies in scope. Once we had conducted a detailed literature review, which made good use of the expert knowledge within the Economic and Social Research Council, we were then able to identify the associated benefits of the *Transparency and Trust* package, including evidence of the important relationship between trust and economic growth. In general, however, the relevant economic literature is in its infancy, which made it unfeasible to monetise the benefits of corporate transparency on the business environment.

214. As explained above, the benefits arising from the potential reduction in crime could not be fully monetised because of the way in which law enforcement agencies collect their data. Given the huge scale of any corporate investigation and the myriad of evidence, there is no systematic distillation of crime data such that we can interrogate the impact of a single factor, such as corporate opacity or specifically opaque beneficial ownership arrangements. We have offered an indication of the scale of the potential benefits but without estimates of the deterrent effect on crime resulting from *Transparency and Trust* measures, we could go no further to monetise them.

215. The evidence we have gathered to inform cost estimates in this Impact Assessment is drawn in large part from a company survey we commissioned through IFF Research. The study was the first of its kind, analysing in detail the costs associated with enhancing corporate transparency. Despite the lengths we went to in order to gather evidence there was still a need for processing of the data to obtain estimates for use in these Impact Assessments, and timing and proportionality constraints with respect to further interrogation of the responses provided to the survey (see **Annex A**).

216. We are satisfied that the evidence presented here represents the most comprehensive and robust assessment available for a Consultation Stage Impact Assessment within the constraints of proportionality with respect to both cost and time. As we develop the evidence base to progress to a Final Stage Impact Assessment we will continue to develop all the sources of evidence available, subject to proportionality constraints.

Table 4: Impact Assessment proportionality analysis

Cost / Benefit	Evidence / Data Gap	Why this evidence has not been included in the IA
Benefits		
Benefits from reduction in crime	(i) Reduction in crime rate (ii) Unit cost of money laundering	• Lack of evidence in the academic literature. • During the consultation, none of the respondents were able to provide quantified evidence in this area. This was often due to data not being recorded in such a form which is easily accessible or usable for economic appraisal purposes. • Paucity of evidence on money laundering is common for all financial crime. As noted by FATF: *"it is absolutely impossible to produce a reliable estimate of the amount of money laundered*[96]*."* • Evidence from the Home Office does not fully disaggregate by type of fraud and only gives a high level aggregate figure.
Reduced costs for Law Enforcement Agencies (LEAs)	(i) Monetised cost impact	• During the consultation, none of the LEA respondents were able to provide quantified evidence on the total reduction in crime or indeed the cost impact. This was often due to data not being recorded in such a form which is easily accessible or usable for economic appraisal purposes.
Corporate transparency and accountability	(i) Measureable growth impact	• Lack of evidence in the literature. There is a clear link between growth and trust but the literature is not yet developed enough to attribute changes in corporate governance to trust and ultimately growth.
Costs		
Familiarisation and set up costs	(i) Number of staff and time taken to familiarise with the proposal (ii) Companies House and IT development and staff costs	• Limitations to scale and scope of company survey with IFF Research. • Initial estimate from Companies House included.
Compliance costs	(i) Separate cost estimates for each of the steps involved in	• Limitations to scale and scope of company survey with IFF Research.

[96] Financial Action Task Force: Money Laundering FAQs

Cost / Benefit	Evidence / Data Gap	Why this evidence has not been included in the IA
	identifying, collating and reporting beneficial ownership data (ii) Compliance costs to individuals	• Unknown number of beneficial owners.
Net impact to the economy	(i) Legitimate investment being diverted from the UK due to the increased exposure that investors might face (ii) Reduced information asymmetry between principals and agents leading to more optimal investment and mutually beneficial trades taking place and an increase in the UK's integrity	• Very difficult to predict the level of investment diverted or increased due to mutually beneficial trades taking place and associate this investment to the disclosure of beneficial ownership.

H. Risks and assumptions

217. For the purpose of this Impact Assessment we have assumed that all companies in scope will have at least one beneficial owner, i.e. one individual who ultimately owns and controls the company. We have based our analysis on the assumption that we will model the beneficial ownership information and disclosure regime on that which currently applies in respect of legal ownership; however, as noted in the body of the Impact Assessment (and at **Annex B**) this is subject to ongoing policy development. We will revise the analysis in the Final Stage Impact Assessment as the policy is further refined.

218. Following standard Impact Assessment methodology, we have assumed 100% compliance. There is, however, a risk of non-compliance and an impact on the criminal justice system. This is set out in the Justice Impact Test, as detailed below.

219. Related to the previous point, there is a risk that benefits from a reduction in criminal activity will not be significant, or that individuals willing to undertake criminal activity might find other ways to hide their interest or involvement in a company. This is not anticipated in this Impact Assessment, but it might have an impact on the level of benefits achieved by the proposals. This risk is likely to be mitigated by robust action being taken across the *Transparency and Trust* package, as envisaged by the suite of proposals. Moreover, crime estimates were only available for England and Wales so we scaled them up to cover the whole of the UK. This enabled us to calculate the volume of crime committed and the associated costs across the whole of the UK.

220. We have and will continue to work closely with law enforcement agencies as we refine the policy to ensure that the registry is implemented such that the information contained supports

timely and effective investigations; and that robust enforcement procedures are in place to tackle instances of non compliance.

221. There may be a risk in terms of individuals opting to use non-UK companies (rather than UK companies) to facilitate crime, which may still have an impact in the UK. However, this risk will be mitigated by ongoing UK action in the G8, G20, FATF and in Europe to encourage other jurisdictions to take similar action.

222. Some respondents to the discussion paper raised concerns around the burden on business and impacts on the attractiveness of the UK as a place to invest; the ability of Government to enforce effectively the new requirements; whether information obtained would be verified for accuracy and how proposals would impact on individuals' privacy rights. We are seeking to address these concerns through policy development where appropriate, and through continued engagement with stakeholders. For example, the development of an exemptions framework from public disclosure for individuals at risk should mitigate concerns around privacy and well-being impacts.

223. The evidence suggests that the *Transparency and Trust* package will as a whole have benefits with respect to growth because of its impact on trust. However, our ability to disaggregate to the level of individual component parts of the package, specifically opacity of company beneficial ownership, is limited. However, on the assumption that the *Transparency and Trust* package will have an impact on trust, the evidence suggests that the package as a whole will have a non-negligible impact on economic growth. We have also made assumptions in adopting the approach of Beugelsdijk (2006) to the relationship between trust and growth. The mechanism through which increasing transparency is considered to affect growth is the enhancement of trust in the business environment. However, the majority of the academic literature related to trust and growth looks generally at societal level trust. Beugelsdijk (2006) considers 'trust' a good proxy for trust in the business environment because trust according to the World Values Survey measure is highly correlated with the effectiveness of institutions.

224. In relation to the cost estimates we have used, there are a series of underlying assumptions:

- We have assumed that the same number of companies will be in scope of non-regulatory approaches under Option 2 as under Option 1.
- The weighted and adjusted mean from the IFF research has been applied to all 3.19m UK active and dormant companies[97]. As policy is refined slight changes to scope might alter this assessment.
- Our costs estimates are largely based on figures derived from an externally contracted survey of almost 600 companies, undertaken by IFF research (see **Annex A**).

225. During the consultation the issue arose of legitimate investment being diverted from the UK due to the increased exposure that investors might face. There is a risk that we have not accurately accounted for this potential impact on overseas investment in the UK and UK competitiveness arising from the package and its perception, particularly since the UK will likely be a 'first-mover.'

226. The OECD has noted as a general principle that: *"excessive compliance costs, shortening the disclosure period and information overload problems, discourage (foreign) investments in*

[97] Company population estimates were extracted from the FAME database (Bureau van Dijk Electronic Publishing, 2013) on 13 December 2013

listed companies and negatively affect shareholder engagement[98]*."* They also note that: *"costs of a disproportionate and stringent disclosure regime makes it more difficult for emerging growth companies to attract public investors, these companies will be induced to rethink their stock market aspirations, thereby hampering economic growth and job creation*[99]*."* These issues might well be relevant for non-listed companies also.

227. Overall, the risk of accounting for this effect with respect to the *Transparency and Trust* package must be contextualised with respect to the significant influence of many other factors on the UK's ability to attract investment. The UK is the 10th most competitive economy in the world (World Economic Forum (WEF) 2013). The WEF highlights the UK's strengths in technology, labour market efficiency, infrastructure, business sophistication and market size, which will by no means be eroded by greater corporate transparency.

228. The main drivers of Foreign Direct Investment would not be likely to be adversely affected by the *Transparency and Trust* package, and indeed could be positively affected. Generally, strong economic fundamentals are thought to be the most important determinants (OECD 2002). In most cases, these include comparative advantage, political and macroeconomic stability, market size, real income levels, the skills base and the quality of the infrastructure (with anonymity of ownership not explicitly referenced as an attractive factor).

229. Moreover, in considering these issues, we should weigh any potential deterrence of investment arising from transparency against the reduced information asymmetry between principals and agents leading to optimal investment and increasing mutually beneficial trades, and a potential increase in the UK's integrity and international reputation as a place to do business and invest. It is not possible, however, to place a monetary value on either any lost investment or any possible increase. We did note, however, that companies with foreign ownership did not, in the surveyed sample, appear to cite higher costs than other companies for familiarisation or compliance with proposals in the *Transparency and Trust* package.

230. In policy terms, we will mitigate the risk of an adverse impact on UK investment by promoting this measure as one of many positive features of the business environment in the UK and continuing to encourage action from other jurisdictions. This will include an active approach in the G8, G20, FATF, and in Europe, and wider promotion of the importance of corporate transparency (e.g. through international best practice guidance and standards). This package of policies places the UK at the very forefront of the international transparency agenda. This has already resulted – and will continue to be a key factor – in the UK shaping the international debate and driving international change.

231. There may also be a risk in terms of individuals opting to use non-UK companies (rather than UK companies) to facilitate crime, which may still have an impact in the UK. Again this risk will be mitigated by ongoing UK action in the G8, G20, FATF and in Europe to encourage other jurisdictions to take similar action.

I. Direct costs and benefits to business calculations (following OITO methodology)

232. The measures the UK has committed to at the G8 are out of scope of One In Two Out on the grounds of implementation being required to meet international obligations.

[98] Vermeulen, E. (2013): *Beneficial Ownership and Control: A Comparative Study - Disclosure, Information and Enforcement* OECD Corporate Governance Working Papers, No. 7.

[99] Kamar, E., P. Karaca-Mandic and E .L. Talley (2008): *Going-Private Decisions and the Sarbanes-Oxley Act of 2002: A Cross-Country Analysis*, USC Center in Law, Economics & Organization Research Paper No. C06-5, USC Law Legal Studies Paper No. 06-10; UC Berkeley Public Law Research Paper No. 901769

233. The G8 is a forum that brings together eight global leaders (Canada, France, Germany, Italy, Japan, Russia, UK and USA, alongside the EU) to address international issues and tackle the most pressing global challenges. The G8 Presidency runs for one calendar year and rotates among the eight member countries, giving each member the opportunity to set the agenda and hold the other Leaders to account. The UK held the 2013 Presidency, and the Prime Minister hosted the annual G8 Summit at Lough Erne in June. The agreements and commitments made by G8 leaders are set out in a formal communiqué published at the annual Summit. These commitments are public and binding.

234. At the 2013 G8 Summit the UK committed to an Action Plan to prevent misuse of companies and legal arrangements[100] from which the measures set out in this Impact Assessment are drawn. Strong action to deliver a package of reform based on the Action Plan is now the minimum the UK must deliver to meet its international obligations. Each other country has published an Action Plan based on common G8 principles.

235. With respect to accountability for the international commitments the UK has made, the Prime Minister and G8 leaders have publicly agreed to: *"ensure G8 members are held to account for their commitments, [on which basis] the G8 agrees to a process of self-reporting through a public update on the progress made against individual Action Plans and to inform the Financial Action Task Force [FATF]."* A FATF follow-up of the implementation of G8 Action Plans is scheduled for presentation in 2014.

236. In addition, since 2009, the G8 has completed an annual accountability exercise to hold itself to account for the development and development-related commitments which are made at G8 Summits. Every three years a comprehensive report reviews all of the commitments within this scope whilst in the intervening years, the Presidency chooses sectors to include in an in-depth report. Each commitment is scored on a five point red/amber/green rating either for the G8 collectively or for individual G8 members depending on the commitment. Moreover, G20 Finance Ministers will report back to G20 Leaders in 2014 on progress made against a commitment in that forum to lead by example to increase transparency of company ownership and control.

237. Although, as international commitments, these measures are not within the scope of One In Two Out, we have, in the interests of good practice, calculated that the preferred option has a direct cost to business of **£86m.**

[100] June 2013: https://www.gov.uk/government/collections/g8-communique-and-documents

J. Wider impacts

Statutory equality duties

238. This policy will primarily impact UK companies (understood here as the individuals responsible for ensuring a company's compliance with the new requirements) and the beneficial owners of those companies. A wider population may derive benefits from the policy as a result of reduced crime or an improved business environment.

239. We have considered whether any of the following groups might be adversely or positively impacted by this policy in different ways:

- Race Equality;
- Gender;
- Disability;
- Age;
- Marriage and civil partnership;
- Religion and Belief;
- Sexual Orientation;
- Gender Reassignment; and
- Pregnancy and Maternity.

240. We do not anticipate that this would be the case and therefore do not anticipate any equalities impact.

Economic impacts

Competition impact test

241. We have considered the potential competition impact of the proposed reforms but this did not identify any particular issues with this policy change.

242. We anticipate that all 3.19m companies will fall into scope, apart from 2,000 to 5,000 listed companies and potentially also their wholly owned subsidiaries (of which there are around 71,000) and/or companies listed on prescribed markets. The listed companies will have already incurred the costs of identifying, collating and reporting their ownership in line with their obligations under the Financial Conduct Authority's Disclosure and Transparency Rules, and their subsidiaries would, in any case, incur little cost in meeting the requirements as the information from their parent would be readily available already. These companies might have incurred some familiarisation costs but support/information from the parent would be likely to have minimised these.

243. With regard to the impact on smaller entrants relative to large existing companies, the estimated mean costs will not disproportionately fall on small companies.

Small and micro business assessment

244. For the purposes of this assessment, the parameter used to define small businesses is up to 49 full-time employees, and for micro businesses up to 10 employees.

245. As set out above, the two main objectives of the *Transparency and Trust* package are to reduce crime, and improve the business environment so as to facilitate economic growth. The

assessment is that excluding small and micro businesses from the policy package could risk a significant impact on the ability of the package to reduce crime, and exclude small and micro businesses from the benefits that can be derived from increased transparency.

246. This policy will apply to all UK incorporated companies and to UK LLPs, and will require these entities to disclose beneficial ownership information to a central registry. There is a default assumption that small and micro businesses[101] should be exempted from new regulatory measures. However, assessment reveals that such an exemption is not viable in this policy context, and not compatible with achieving a large part of the intended benefits of this measure.

247. It has been widely identified that 'shell' companies are often the vehicle of choice for money-laundering and other crimes[102]. A 2012 study defines a shell company thus: *"In contrast to operating or trading companies that have employees who make a product or provide a service […] shell companies are little more than this legal identity, and hence the "shell" moniker"*[103]. By this very definition, we believe that the majority of shell companies would be classified as small and micro businesses. Law enforcement have strongly confirmed to us that this is the case, and that excluding small and micro businesses from scope would be a significant risk and ultimately counterproductive. Internationally, the USA G8 Action Plan considers targeting small and micro business for selective **inclusion** in scope of company beneficial ownership transparency, and considering larger businesses for exemption where they meet *"certain employee or revenue requirements."*

248. Allowing any exemptions targeted at small and micro business could therefore have a negative impact on the primary derived benefit from this policy, in terms of a failure to tackle or deter any illicit activity undertaken through companies currently on the register. Exempting small and micro businesses from the requirement would create a significant loophole for those seeking to exploit the company structure for illicit activity in future. In turn, this could damage the reputation of UK small and micro businesses relative to their larger and/or international competitors.

249. Moreover, any exemption for small companies would limit the positive impact on the wider building of trust in the business environment - and therefore economic growth. Were they to be exempted from these transparency requirements, information asymmetries could persist and law-abiding businesses might find themselves, for instance, less able to attract private investment or debt finance.

250. We have undertaken a preliminary analysis of the costs for small companies using the data obtained in the IFF Research company survey. Notably, the costs estimates split by company size do not generate the same total cost figures that we calculated above because they are weighted differently. This ensured that the estimated means were not distorted upwards by the small proportion of companies classified as 'complex' in structure. We will revisit this in the Final Stage Impact Assessment to obtain more definitive estimates.

251. Weightings were constructed by the same methodology as for the overall figures (see **Annex A**) except once the data were split into 'small' and 'large' companies, they were weighted only by structure (simple, reasonably complex and complex). This ensured that the estimated

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101 For the purposes of this assessment, the parameter used to define small businesses is up to 49 full-time employees, and for micro businesses up to 10 employees.

102 Findley, Nielson and Sharman (2012): *Global Shell Games: Testing Money Launderers' and Terrorist Financiers' Access to Shell Companies* http://www.griffith.edu.au/business-government/centre-governance-public-policy/research-publications/?a=454625

103 *ibid*

means were not distorted upwards by the small proportion of companies classified as 'complex' in structure. As per the overall data, for each truncated mean (99th percentile, 98th percentile etc) the weighting was influenced firstly by the share of companies from the population in each structure classification and the number of remaining observations of each structure classification in the sample.

252. The survey data suggest that the average costs for the 3.13m small companies will be substantially lower than for large companies, as set out in the table below.

Table 5: Average costs for small companies

Costs	Small company mean	Large company mean
Transition costs per company	£198	£545
Ongoing costs per company	£57	£148

253. Nevertheless, from the outset we have considered measures to minimise burdens to small and micro businesses, including allowing a sufficient time for companies to familiarise themselves with these changes and providing sufficient guidance on the policy. We will take steps to identify and fulfil any particular guidance requirements of small and micro businesses in order to support them, in particular, in understanding the new requirements. We have not identified any other potential unintended effects to these businesses, and assuming 100% compliance, the impact will not disproportionately impact small and micro businesses.

254. We will also continue to develop the implementation of the policy change to be as simple as possible for all users but particularly those in small and micro businesses, in terms of interfaces and forms etc.

255. We have not identified any other potential unintended effects to these businesses, and assuming 100% compliance, the impact will not disproportionately impact small and micro businesses.

256. With these points in mind, our assessment against the advised considerations is as follows:

Full exemption

257. We do not believe a full exemption is compatible with achieving crime reduction benefits; and would reduce benefits derived from a more open and trusted business environment.

Partial exemption

258. At this stage, we have not identified any specific requirements within the proposals from which we would be able to exempt small and micro businesses. We do not believe any exemption is compatible with achieving a large part of the intended benefits.

Extended transition period

259. We do not believe a separate transition period for small and micro companies is compatible with achieving a large part of the intended benefits. We will ensure that a sufficient transition period is in place for <u>all</u> companies and that there is sufficient time for a well-supported process of familiarisation and transition.

Temporary exemption

260. We do not believe a temporary exemption for small and micro companies is compatible with achieving crime reduction benefits, not least because anonymous shell companies are the specific focus of our proposals. Exempting them could therefore provide a means for illicit activity to continue unnecessarily.

Varying requirements by type and/or size of business

261. We have not identified a specific type of business that is more or less likely to engage in illicit activity; indeed many of the companies in question will not conduct any business activity. As small, anonymous shell companies are the focus of our proposals it would not be appropriate to vary the requirements for small and micro companies. This would not be compatible with achieving a large part of our intended benefits. Where possible, we have sought to use existing precedents which apply to all UK companies.

Direct financial aid for smaller businesses

262. We do not believe that the costs of complying with this policy change per company will warrant direct financial aid.

Opt-in and voluntary solutions

263. We have considered and discounted non-regulatory approaches in our Impact Assessment, given the nature of the criminal activity we seek to address. For the same reasons as set out under Option 2 generally, we do not believe that small and micro companies' engaging voluntarily would be a viable solution or compatible with achieving a large part of our intended benefits.

Specific information campaigns or user guides, training and dedicated support for smaller businesses

264. There might well be a case for tailored information campaigns and user guides, though training is not likely to be required. We will work on meeting the needs of the small and micro business user as we develop overall guidance to support the introduction of the package, and as part of the Government's wider communications campaign.

265. We will continue to develop proposals with a view to a post-implementation review and consider carefully the development of review clauses in legislation. We have considered the value of sun-setting clauses but ultimately view the policy proposals as making longstanding improvements to the UK legal framework. While review and optimisation should continue following implementation, the changes we make must be seen to be enduring in order to deliver the benefits from a reduction in crime and from improvements to the business environment, and particularly in order to meet the UK's international obligations to deliver change in these areas.

Environmental impacts

266. Our analysis suggests that this policy will not have any adverse impact on the environment – the changes relate purely to gathering, collating and centralising data, and we anticipate this will be done digitally in the majority of cases.

Rural proofing

267. Our analysis suggests that this policy will not have any adverse impact on rural areas – the changes relate purely to gathering, collating and centralising data, and we anticipate this will be done digitally in the majority of cases.

Sustainable development

268. Our analysis suggests that this policy will not have any adverse impact on sustainable development – the changes relate purely to gathering, collating and centralising data, and we anticipate this will be done digitally in the majority of cases.

Social impacts

Health and well-being

269. This policy should reduce crime which will have a positive impact on individuals' well-being. We have sought to mitigate any potential adverse impact on health or well-being as a result of enhanced transparency (e.g. to individuals investing in companies carrying out controversial activities) by providing that there will be an exemptions framework for individuals that might otherwise be at risk of harm. Beneficial ownership information in these cases will not be placed in the public domain and only specified enforcement authorities will have access.

Human rights

270. We do not believe that our proposal to implement a central registry of company beneficial ownership information contravenes our commitments to the European Convention of Human Rights (ECHR).

271. Article eight, section one of the ECHR states that:

"*Everyone has the right to respect for his private and family life, his home and his correspondence. There shall be no interference by a public authority with the exercise of this right except such as is in accordance with the law and is necessary in a democratic society in the interests of […] the prevention of disorder or crime [...].*"

272. Implementation of a publicly accessible central registry of company beneficial ownership means that we are exposing personal data on individuals with a significant beneficial interest in a UK company to anyone who chooses to search for it. However, it is important to note that:

- similar information is already being held on the public record - for example, on company shareholders and directors; and some of the required beneficial ownership information will already be in the public domain (e.g. where the company director is the company's beneficial owner);
- only information on individuals with a significant beneficial interest in a UK company will be held (i.e. individuals with an interest in more than 25% of the company's shares or voting rights; or who otherwise control the way the company is run); and
- there will be a framework of exemptions from public disclosure for individuals at risk.

273. In addition, one of the policy objectives is to reduce crime through tackling the potential for misuse of companies; and there is international agreement (for example, at G8 and through the FATF standards) around the importance of enhanced corporate transparency. This further justifies our analysis that our proposal does not contravene our ECHR commitments.

Justice System

274. Justice Impact Tests are currently under discussion with the Ministry of Justice.

275. This Impact Assessment assumes 100% compliance with the policy. A Justice Impact Assessment Test has also been completed.

276. We anticipate that we will extend the application of existing company law offences or use existing company law offences as a precedent for the creation of similar offences to deal with instances where companies or individuals fail to provide beneficial ownership information; or deliberately provide false information.

277. We anticipate however that most instances of non-compliance would be dealt with by Companies House through their usual compliance procedures. For example, Companies House estimate that in 85-90% of cases they write to the company in the first instance, before referring the matter to BIS or other enforcement agencies, or taking action themselves.

K. Summary and preferred option with description of implementation plan

Summary

278. The preferred option is Option 1, implementation of a central registry of company beneficial ownership information.

Table 6: Summary of options

Cost / Benefit	Option 1 (Central Registry)	Option 2 (Non-regulatory)	Which Option performs better?
Benefits			
	There is little quantified data about the benefits from this policy proposal. Benefits will be associated with: (1) reduction in crime including increased efficiency by law enforcement agencies; reduced due diligence costs for regulated entities; reduced criminal activity and, from this, efficiency and welfare gains to the economy (reduction in fraud crimes estimated at **£523m** pa); and (2) increased transparency which could	No benefits from reduced crime are expected under this option, given that a voluntary approach would not fully help to deter, disrupt and sanction criminal activity. There might be some deterrence benefits if companies want to incorporate a company in the UK, but these are expected to be limited. Overall this option is not likely to achieve the desired objective of the policy.	Option 1 performs better than Option 2 in terms of achieving the desired benefits. This is because the regulatory approach is more likely to deal with the crime element of the proposal.

Cost / Benefit	Option 1 (Central Registry)	Option 2 (Non-regulatory)	Which Option performs better?
	potentially have an impact on economic growth.		
Costs			
	Costs to Government are estimated to be **£51-110k** for the IT development of the registry and communication and **£220k** pa on-going for the maintenance. Cost to businesses are estimated to be **£226m** set up cost (familiarisation, identification, collection, collation and storage of data), and **£78m** pa on-going costs from updating information and providing returns to Companies House.	There are likely to be costs to the public sector associated with promoting the voluntary approach. For example, communications campaigns and business engagement and costs of IT development for Companies House. These costs depend on the scale of the campaign but are estimated at around **£0.5m**.	In terms of costs to Government Options 1 and 2 would perform at the same level, given that in both cases Companies House will need to set up systems to capture and store the data. However, costs to Companies House might be lower under Option 2 as there would be no 'at risk' beneficial owners identified and hence no need to support a closed register. In terms of costs to the private sector, clearly Option 2 will impose fewer costs than Option 1 and these costs would be voluntary. However, costs should not be considered on their own but in the context of the benefits stated above. On balance, considering costs and benefits of each option it is thought that Option 1 would perform better.

Implementation plan

279. At the UK-chaired G8 Summit in June 2013, and following six months of international negotiation (led by the Cabinet Office on behalf of the UK), G8 Leaders recognised the problem of corporate opacity, including in respect of hidden company beneficial ownership, and agreed to publish national Action Plans setting out the concrete steps they would take to address this.

280. The UK published its Action Plan at the Summit, which set out a number of commitments, including to implement a central registry of company beneficial ownership information. BIS, as the department with responsibility for company law and corporate governance, is responsible for the implementation of this commitment, working closely with other Government departments including HM Treasury and the Home Office.

281. In July 2013 BIS therefore published a discussion paper setting out measures to enhance the transparency of UK company ownership. This included proposals to implement a central registry of company ownership. This Impact Assessment reflects the outcome of that call for evidence, as well as the other evidence gathering mechanisms outlined in this document.

282. This reform necessitates primary legislation. It is our intention to take forward this policy as soon as Parliamentary time allows.

283. Once the policy has completed its Parliamentary passage, we would seek to implement the following high level implementation plan. This will be refined as the policy - including transitional arrangements, and related proposed changes to company law - is further developed.

- **Month 0**: Parliamentary passage of primary and secondary legislation.
- **Following Parliamentary passage**: Royal Assent, commencement of primary and secondary legislation.
- **On Royal Assent**: Guidance developed and communicated to UK companies and their advisors.
- **On Royal Assent or specified period post Royal Assent**: Central registry becomes operational, UK companies required to provide beneficial ownership information to Companies House.
- **From date of operation of registry**: Compliance processes led by Companies House.
- **From date of operation of registry**: Enforcement action led by Companies House, BIS and UK enforcement and tax authorities.
- **2016:** Peer review of UK implementation of FATF recommendations.
- **Royal Assent plus 5 years**: Review of legislation.

284. Following implementation, we will undertake the requisite post-implementation review (PIR).

Annex A – Methodology : The IFF Transparency and Trust Survey

A. Background

1. During consultation on the *Transparency and Trust* discussion paper, to inform policy development and the Impact Assessment process, we have:

   - consulted with the Economic and Social Research Council;
   - consulted with Companies House;
   - undertaken a full literature review;
   - opened an online survey accessible by the general public;
   - consulted with business, regulated entities and law enforcement agencies in a series of focus groups and one-to-ones meetings; and
   - undertaken a large scale company survey.

2. On this final point, IFF Research conducted a survey of UK companies on behalf of BIS, starting in August 2013. BIS worked with IFF to develop a mix of qualitative questions and quantitative cost estimates of 574 companies. The survey was intended to examine the impact of proposed corporate transparency reforms on a range of companies, of varying size and ownership structure. Companies were asked questions in order to explore the likely cost impact of establishing a central registry of beneficial ownership, opaque arrangements involving company directors and the disqualification of certain directors.

3. In order to allow us to derive estimates of costs, the questions asked typically requested information on which members of staff would be involved in a given compliance process and how long it might take, and some direct questions relating to costs.

4. The total cost figures were calculated based on estimates for the number of hours it would take particular employees to comply with the proposals. Once IFF Research compiled these data, they were multiplied by the hourly wage rates taken from the Annual Survey of Hours and Earnings (ONS, 2012)[104].

B. Issues with the survey

5. In-depth analysis of the survey methodology and responses has since highlighted several issues. When the survey questionnaire was designed (August 2013), policy was in the early stages of development and remained the subject of consultation. The tight timeframe was necessary in order to inform the policy development and Impact Assessment schedule, but it has meant that the specific requirements of companies (e.g. the nature of familiarisation and compliance) were not fully defined, and therefore were not clearly or comprehensively presented to companies to inform their responses. In fact, IFF Research explained to BIS that some respondents struggled to answer the questions and some had varying interpretations as to what the questions meant for them.

6. **We believe these issues have had an effect on the robustness of the responses and therefore on their overall suitability for unqualified use in analysis of the costs and benefits of the proposed** reforms and their role in our Impact Assessments. These are outlined below.

[104] The statistics taken from ASHE are based on the median rather than the mean. This is the preferred measure of earnings as it is less affected by a relatively small number of very high earners and the skewed distribution of earnings. It therefore gives a better indication of typical pay than the mean. The survey takes a sample of employee jobs drawn from HMRC records of gross pay before tax, National Insurance or other deductions. These data were then uplifted by 17.8% to reflect non-wage costs (i.e. National Insurance, pension contributions, other payroll taxes and other non-statutory employee services such as transport and canteen provision). This is in accordance with Eurostat data and forms a standard assumption.

7. We identified a number of striking distributions across the survey questions. The data we received showed a number of respondents who estimated costs which were extremely high, in contrast to a 'long tail' of respondents who estimated zero costs.

8. For instance, the question relating to familiarisation costs for the creation of a registry of company beneficial ownership, yielded the following distribution of responses:

Figure 1: Distribution of responses on the costs of familiarisation related to beneficial ownership

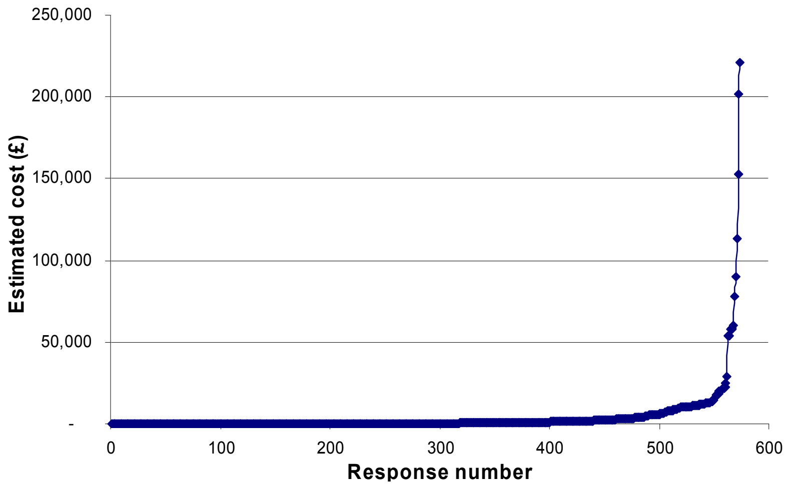

Table 1: Familiarisation costs related to beneficial ownership

Staff Cost (£)		Additional costs (£)		Total costs (£)	
Mean	Median	Mean	Median	Mean	Median
1,087	145	1,124	0	2,211	196

9. Close interrogation of this 'tail' of high responses has not indicated any discernible pattern; that is to say, the companies which gave high responses did not consistently adhere to any identifiable characteristics. We might have expected higher costs for larger and more complex companies, but in the context of analysis of these respondents there was no relationship between cost[105] and size (based on turnover, employees and assets) and complexity (based on the number of layers of share ownership).

10. If we compare the estimates of familiarisation costs produced by the present survey to other estimates of familiarisation costs, they are revealed to be noticeably higher. Recent modelling from Companies House[106], indicates that the familiarisation costs for a broadly comparable measure are substantially lower; modelling indicated it would take companies 20 minutes to familiarise themselves with a comparable policy, which was multiplied by £19 – the mid point between the median wage and the wage of a company director – to give a total familiarisation cost of around £6. Discussion with business representative organisations suggested that estimates based on these parameters were likely to be reasonable.

11. We identified similar differences when comparing other parts of this survey to wider evidence; the ongoing costs of complying with the policy also appear to have been significantly overestimated. The

105 Although there was a slight tendency for those giving high responses to be 'large' – around 60% were.
106 Detail in cost benefit analysis within consultation on *Company Filing Requirements* (October 2013, BIS)

present survey estimated costs for companies providing information on beneficial ownership to Companies House each year (as one part of the total ongoing costs) as set out below:

Table 2: Costs of reporting beneficial ownership to Companies House

Staff Cost (£)		**Additional costs (£)**		**Total costs (£)**	
Mean	Median	Mean	Median	Mean	Median
212	48	149	0	361	48

12. The estimates in Table 2 are at odds with another previous estimate. In 2007, PWC were commissioned to produce an Administrative Burdens Measurement Exercise. This exercise estimated administrative burden of regulations across a number of policy areas. PWC estimated the cost of completing, signing and returning a Companies House form (form 692[107]) to be £10.73 per company, which uprated to 2013 prices is £12.39. This process is broadly comparable to some of the requirements in the *Transparency and Trust* package (such as reporting simple information on beneficial ownership to Companies House) but, again, the IFF estimates look inexplicably high[108].

13. In addition, respondents who gave extreme values were not asked further questions to allow us to understand what drove their estimates. Analysis showed that the majority of the costs were driven by very high responses to questions relating to 'additional costs' (as shown in Table 1); that is costs identified by companies in addition to staff time. These were quoted in asking the question as 'legal, third party costs, etc.' but the exact detail of what companies thought they would involve was not determined.

14. For the reasons set out above, we now believe that the survey questions which asked for cost estimates lacked the specificity required to elicit fully informed or meaningful answers. The combination of the methodological concerns, the discrepancy between different respondents and between these and other analyses points to the need for further analysis to understand the costs to business of these reforms. This is particularly the case since we are continuing to refine the policy.

15. We have used statistical techniques for this iteration of the Impact Assessment to adjust the impact of extreme values. The steps we have taken to process the data for use in the present Impact Assessment are set out below. We will pursue further analysis as a priority for the Final Stage Impact Assessment.

C. Methodology for the current Consultation Stage Impact Assessment

16. Despite its flaws, the survey is the most comprehensive dataset available, and we believe there is value in processing it to produce realistic and duly qualified cost estimates. As an interim measure, for this iteration of the Impact Assessment, we have truncated the mean to adjust for extreme values. As context for doing so, we have considered the evidence from sources as discussed above and our conversations with business representative organisations. We have also considered the issue of additional costs.

17. Firstly it is necessary to consider and exclude zero values from the estimated mean (which will have the consequence of increasing our estimated costs). A large number of survey respondents answered that there would be zero costs arising from the proposed policy changes. This seems

107 The form deals with any alteration made in the Directors or Secretary of an overseas company or the particulars contained in the list of the directors and secretary.

108 For instance, the response to the survey question: *"Costs as a result of providing beneficial ownership information to a central register on an annual basis"* yielded an unadjusted mean response of £160 – more than twelve times higher than the PWC figure for a similar process.

counter-intuitive, because all companies would need to spend at least some time understanding a form, even if just to determine that no or limited action is necessary. Therefore these observations have been removed. We will test this overall assumption with respect to each question or facet of the costs in further research, which will feed in to the final version of the Impact Assessment.

18. It is also necessary to exclude implausible or unverifiable estimates at the opposite end of the distribution. We used the truncated mean for each survey question relating to costs based on the shape of the relevant distribution (i.e. truncating the mean where the costs go beyond what we would consider feasible on a question by question basis).

19. The aim of these two changes is to deliver a more realistic cost estimate to apply to the general population of companies.

20. The next issue relates to whether the responses to questions around additional costs should be included. As set out above, the responses to the non-staff costs were implausibly high when compared with other evidence sources. The question was open-ended and did not define the sorts of costs that should be included, and IFF reported that there were very significant differences in interpretation of these questions across respondents, with some highly unusual interpretations. They were clear that the lack of question specificity was a particularly acute issue with these questions. Therefore we decided to exclude these responses from our analysis. We intend to return to this issue in the further analysis which we will conduct for the next iteration of the Impact Assessment.

21. The raw sample data were weighted according to their size and structure (as per the share of all companies in each of the 6 cells in the 3x2 grid) and according to the number of observations of each of the 6 company types in the sample. The process was as follows:

    i) Percentage of the population in each of the 6 cells x number all sample observations (excluding zeros and truncated observations)
    ii) Total number of non-zero truncated sample observations for each of the 6 cells
    iii) Divide (i) by (ii)

22. This calculation was necessary for each truncated mean and for each cell because once the data were truncated, a given number of observations were removed from the sample. The weightings, therefore, needed to be adjusted for each truncation to ensure that raw sample data were not inappropriately weighted after observations were removed.

23. The table below indicates that mean costs of beneficial ownership without any data adjustment lead to total transition costs of £6bn (excluding additional costs). Using a mean truncated at various percentiles depending on the question (but mainly between 85th and 95th percentile) and excluding zero costs would reduce transition costs to £226. For clarification the total figures in the table below have been calculated by multiplying the total mean by 3,187,112 (the exact number of companies affected, rounded in the rest of the IA at 3.19m), except for the mean for '*costs as a result of responding to a request about your beneficial ownership'* which has been multiplied by 130,000 companies (number of companies with subsidiaries).

Table 3: Transition costs for beneficial ownership

	Mean Transition costs (£)	Total transition cost (£)
MEAN STAFF COST	2,643	6,161,205,009
MEAN STAFF COST EXCLUDING ZEROS	3,929	8,887,503,906
99th percentile - trimmed staff mean	1,035	2,632,019,490

	Mean Transition costs (£)	Total transition cost (£)
98th percentile - trimmed staff mean	668	1,744,583,947
97th percentile - trimmed staff mean	475	1,268,605,013
96th percentile - trimmed staff mean	369	983,130,473
95th percentile - trimmed staff mean	284	758,908,535
94th percentile - trimmed staff mean	228	604,281,183
93rd percentile - trimmed staff mean	185	491,448,954
92nd percentile - trimmed staff mean	159	421,677,725
91st percentile - trimmed staff mean	133	354,135,746
90th percentile - trimmed staff mean	113	306,361,034
89th percentile - trimmed staff mean	97	265,999,072
88th percentile - trimmed staff mean	87	238,351,151
87th percentile - trimmed staff mean	76	210,117,527
86th percentile - trimmed staff mean	68	187,106,056
85th percentile - trimmed staff mean	60	167,142,408
84th percentile - trimmed staff mean	55	153,260,179
83rd percentile - trimmed staff mean	50	137,422,216
82nd percentile - trimmed staff mean	45	123,863,220
81st percentile - trimmed staff mean	40	110,598,428
80th percentile - trimmed staff mean	37	100,785,206
79th percentile - trimmed staff mean	33	90,957,608
78th percentile - trimmed staff mean	30	82,712,246
77th percentile - trimmed staff mean	28	76,372,980
76th percentile - trimmed staff mean	27	72,333,866
75th percentile - trimmed staff mean	25	68,198,829
70th percentile - trimmed staff mean	18	49,956,684
65th percentile - trimmed staff mean	14	38,296,884
60th percentile - trimmed staff mean	12	31,538,853

25. Applying a similar approach to ongoing costs, the overall costs without adjustment are £1.3bn (excluding additional costs). Using a mean truncated at various percentiles depending on the question (but mainly between 85th and 95th percentile) and excluding zero costs would reduce ongoing costs to £78m.

26. For clarification the total figures in the table below have been calculated by multiplying the total mean by 3,187,112 (the exact number of companies affected, rounded in the rest of the Impact Assessment at 3.19m).

Table 4: Ongoing costs for beneficial ownership

	Mean ongoing cost (£)	Total ongoing Cost (£)
MEAN STAFF COST	424	1,350,076,276
MEAN STAFF COST EXCLUDING ZEROS	551	1,756,516,590
99th percentile - trimmed staff mean	208	661,466,943
98th percentile - trimmed staff mean	142	453,476,388
97th percentile - trimmed staff mean	113	359,754,822
96th percentile - trimmed staff mean	97	309,768,940
95th percentile - trimmed staff mean	84	267,651,076
94th percentile - trimmed staff mean	72	227,929,225

	Mean ongoing cost (£)	Total ongoing Cost (£)
93rd percentile - trimmed staff mean	62	197,437,799
92nd percentile - trimmed staff mean	55	175,850,013
91st percentile - trimmed staff mean	47	150,697,480
90th percentile - trimmed staff mean	40	127,991,687
89th percentile - trimmed staff mean	34	107,069,587
88th percentile - trimmed staff mean	29	93,031,414
87th percentile - trimmed staff mean	25	80,698,899
86th percentile - trimmed staff mean	22	69,438,684
85th percentile - trimmed staff mean	19	60,256,757
84th percentile - trimmed staff mean	17	55,020,454
83rd percentile - trimmed staff mean	16	49,540,761
82nd percentile - trimmed staff mean	14	45,351,253
81st percentile - trimmed staff mean	13	41,686,526
80th percentile - trimmed staff mean	12	38,843,502
79th percentile - trimmed staff mean	11	35,947,476
78th percentile - trimmed staff mean	11	33,569,646
77th percentile - trimmed staff mean	10	31,393,818
76th percentile - trimmed staff mean	9	29,735,628
75th percentile - trimmed staff mean	9	27,951,042
70th percentile - trimmed staff mean	7	21,481,408
65th percentile - trimmed staff mean	5	16,617,180
60th percentile - trimmed staff mean	4	14,062,244

27. This approach has limitations because we are losing a significant number of observations with corresponding impacts on the standard errors. The trimmed observations will be lost from both the top end of the distribution (where we are truncating based on the percentiles detailed in the table) and from the bottom end (where we have excluded all zero observations). Table 5 details this.

Table 5: Final samples by question

	Number of zero observations	Zero observations as % of all observations	Truncated mean percentile
B3. Costs as a result of company familiarisation with the proposed reforms	67	12%	85th
C2. Costs as a result of identifying and collecting information about the beneficial owner	387	67%	90th
C3. Costs as a result of responding to a request about your beneficial ownership	185	32%	95th
C4. Costs as a result of collation, process and storage of beneficial owners data	162	28%	94th
C5. Costs as a result of updating beneficial ownership information on an annual basis	119	21%	85th
C7. Costs as a result of providing beneficial ownership information to a central register on an annual basis	76	13%	85th

	Number of zero observations	Zero observations as % of all observations	Truncated mean percentile
D1. Costs as a result of ensuring your company is familiar with proposed reforms to prohibit corporate directors	186	32%	98th
D7. Costs as a result of removing and then replacing the corporate director	147	26%	96th
D8. Costs as a result of removing or updating your corporate directorship	165	29%	98th

28. However, the alternative to using the survey data would be to rely on other estimates which are limited in scope, and leave substantial gaps in the evidence base. For this reason, our view is that the only feasible approach is to use the adjusted survey data as discussed above, and we have therefore adopted this approach consistently throughout our analysis.

Annex B: Sensitivity Analysis

1. The following elements of the policy will be further developed as we move towards implementation of the legislation, including as a result of further engagement with enforcement agencies and industry, and Parliamentary passage.

Option 1 – A publicly accessible central registry of company beneficial ownership information: Preferred option

2. The assessment of the costs and benefits of Option 1 is based on an analysis of the proposed policy framework. However, as indicated in the 'description of options considered', there are a number of policy variables under consideration. These may ultimately impact the costs and benefits and will be refined in the Final Stage Impact Assessment.

3. Given the high level nature of the costs and benefits, and the scale of the unknowns, it is not possible to monetise the relative costs and benefits of these variables. We have however provided a qualitative assessment below, which we will refine as the policy is further developed:

(1) The definition of beneficial ownership

4. The 25% threshold could be decreased or increased; however this is not currently under consideration for the reasons outlined in the description of Option 1.

(2) The scope of the registry

5. It is proposed that UK companies and Limited Liability Partnerships are in scope of the registry, and that companies listed on a regulated market are out of scope. We may ultimately exclude additional types of company, for example, companies listed on prescribed markets such as AIM and wholly owned subsidiaries of listed companies; or include other types of corporate entity.

6. Increasing the number of exempt companies would decrease the overall regulatory cost impact of the proposal. For example, there are around 750 UK companies listed on the AIM market which would not then be required to provide information to the central registry. In addition, these types of companies might be expected to have more complex and changing ownership structures, so the cost per company of obtaining beneficial ownership information might be higher; again contributing to a lower overall cost of reform.

7. On the other hand, whilst the risk of misuse of these companies is arguably lower than for private companies with much more limited public scrutiny (AIM listed companies, for example, are required to disclose ownership interests above 3% under the FCA *Disclosure and Transparency* rules), it is also arguably higher than for companies listed on regulated markets subject to additional regulatory requirements. Their exclusion might therefore create undesirable 'loopholes', which would reduce the overall benefits of the policy from the perspective of crime reduction and general good corporate behaviour through enhanced transparency.

8. If we do ultimately opt to exclude additional types of company, we might still require them to report where beneficial ownership information is disclosed (e.g. to the market) or why they are exempt from the requirement to provide the information (e.g. because their parent company is a listed company). We will need to further consider the costs of these variables in due course.

9. If we were ultimately to place more types of corporate entity in scope, the same arguments as above would apply in reverse. In other words, the regulatory costs would increase, but we might derive greater benefits as a result of more entities providing the information. However, we envisage that the overall impact of such a scope change would be minimal either way given the type and number of these other entities.

10. As we draft the legislative changes necessary to implement the policy, we will continue to discuss this issue, on an informal and ongoing basis, with regulators, enforcement agencies and industry in order to formulate the final policy.

(3) How beneficial ownership information is obtained

11. It is proposed that disclosure obligations are placed on both companies and beneficial owners. We might, alternately or in addition, ultimately opt to place a disclosure obligation on the legal owners of a company as well.

12. This might increase the efficacy of the policy in terms of ensuring that all beneficial ownership information is obtained. For example, because legal owners are recorded on the company's register of members, it should be easier for companies and enforcement agencies to identify the legal owner who has not provided information compared to identifying an unknown beneficial owner. However, if the additional requirement was *only* placed on the legal owner, the outcome might be less effective if the legal owner could not identify the beneficial owner.

13. In the majority of cases where companies have a simple ownership structure we would expect the legal owner and beneficial owner to be the same; so there would be no additional cost or complexity to the policy as a result of this added requirement. However, this will not be the case for companies where the legal and beneficial owner are two different persons. In those cases, if an additional disclosure requirement was imposed, the overall cost will increase as the number of parties involved increases. There might also be additional inefficiency through duplicative disclosures being made by multiple parties.

14. As we draft the legislative changes necessary to implement the policy, we will continue to discuss this issue, on an ongoing basis, with enforcement agencies and industry in order to formulate the final policy.

(4) Providing and updating information in the central registry

15. Companies will be required to obtain information on their beneficial ownership and provide it to the central registry. We might model the information and disclosure regime on that which currently applies in respect of company legal owners (i.e. shareholders). Alternatively, we might require more information to be collected and held in the registry, for example, dates of birth.

16. Collecting and holding additional information should enhance the utility of the registry for law enforcement agencies, in terms of their ability to quickly identify the individuals in question without alerting the individual or company to the investigation. A date of birth, for example, might be particularly useful where the individual in question had a very common name or had provided a service address rather than a residential address.

17. We would need to consider carefully whether any additional information collected was made available publicly from the perspective of data privacy and individual safety. The more

information available publicly, the more extensive and therefore expensive any exemptions framework from public disclosure may need to be.

18. However, if additional information is held privately, this might also increase public sector costs in terms of maintaining a secure registry of information available only to prescribed bodies (which might ultimately be passed on to business through increased fees); and would potentially reduce the benefits derived from allowing public scrutiny of the information (i.e. increasing the likelihood of errors and omissions being detected). The benefits to, for example, regulated entities or developing countries may be similarly decreased if any additional held is not made available publicly.

19. Requiring additional information may also increase the cost to business and individuals. For many companies, its legal owners will also be its beneficial owners. So in these cases, if the information required from legal and beneficial owners is the same, companies and individuals may not need to collate or provide any additional information. This may not be the case if additional information must be obtained, and so there may be additional costs (which may be offset if companies already hold this additional information following AML due diligence checks).

20. If information requirements for legal and beneficial owners are not the same, familiarisation costs might also increase and there may be additional costs for the company in terms of holding extra data fields on its systems or maintaining information confidentially. There should however be minimal cost impact in terms of updating this information – date of birth, for example, will not change.

21. In terms of how often beneficial ownership information is updated, we might again look to the company shareholder regime as a model. This would mean that information held by the company would need to be updated as it changed; and the registry would be informed of any changes on an annual basis. Alternatively, we might require the company to notify the registry of changes within a certain number of days of the change. This would reflect the current model that applies in relation to directors' details needing to be updated at Companies House.

22. Requiring information to be updated at the registry as it changes may enhance the utility of the registry as it would be more likely to be up to date; and might prevent companies from deliberately changing their beneficial ownership just before an annual update – and then amending it immediately afterwards. However, 'real-time' updates might need to be supplemented by a mandatory annual check – otherwise companies might forget to update the information at all, thereby decreasing the integrity of the register.

23. For some companies, updating information at it changes might be less costly because their beneficial ownership changes less than annually – however, any such benefits would be reduced if there was a mandatory annual check as well. For other companies whose beneficial ownership changes more frequently, an annual update would be less costly. Replicating the legal ownership regime might also decrease familiarisation costs for companies.

24. Amending the notification regime and the information to be held in the registry would also impact on public sector costs. Companies House has indicated that if information is provided on the basis of new notifications, this would cost £39k - £78k, depending on whether the notification was in addition to the annual return. If any or all of the information was restricted from the public - e.g. date of birth - it would cost an additional £19.5k to develop the necessary system validation and secure access. A further £39k would be budgeted for contingency.

25. The outcome of the consultation on company filing requirements, specifically on the future of the annual return, will also impact these costs. We are assuming that development would be necessary to remove the annual return or move to a check and amend facility and so the costs here are at the lower end of the scale. These costs only account for development and do not include any other business costs such as training or communication. If there is insufficient internal development resource external resource may be required which would cost significantly more.

Table 1: Summary analysis of key variables under consideration

Variable	Benefit impact	Cost impact
Additional companies exempted (e.g. AIM listed companies)	Potential lower benefits to Government – if these companies were misused, information on their beneficial ownership would not be held at Companies House; corresponding lower benefits to individuals and business as a result in terms of potential crime impacts. More limited benefit to regulated entities, and those who engage with the company - they will not have access to beneficial ownership information via Companies House.	No significant impact on public sector costs anticipated. Lower overall regulatory cost to business - particularly as the individual cost to these companies of obtaining and updating beneficial ownership information might be higher for these companies than for other companies. Potentially corresponding lower costs to individuals overall, as the total number of individuals required to make a disclosure to a company will decrease.
Additional companies included (e.g. other corporate entities)	Potential increased benefits to Government – if these entities were misused, information on their beneficial ownership would be held at Companies House; corresponding increased benefits to individuals and business as a result in terms of potential crime impacts. Increased benefit to regulated entities, and those who engage with the entity - they will have access to beneficial ownership information via Companies House.	No significant impact on public sector costs anticipated. Increased overall regulatory cost to business and individuals overall, as the total number of corporate entities and individuals required to make a disclosure and provide information to Companies House will increase.
Disclosure obligations placed on the legal owner (in addition or alternately to obligations being placed on the	Potential additional benefit to Government (and individuals and business by extension) and regulated entities if more complete beneficial ownership information is obtained as a result of an additional disclosure	No significant impact on public sector or industry costs anticipated. The latter may decrease marginally if a company was required to make fewer direct enquiries to obtain beneficial ownership information; although

Variable	Benefit impact	Cost impact
beneficial owner)	requirement being imposed. Impact likely to be more nuanced if the requirement is imposed as an alternative.	could increase where the company is itself a legal owner. Potentially higher number of individuals required to make a disclosure, leading to higher overall costs.
Requiring additional data fields to be held by the company and Companies House (e.g. date of birth)	Potential additional benefit to Government through increased ability to identify individuals and business using the central registry. Corresponding increased benefits to individuals as a result in terms of potential crime impacts. Subject to access provisions, likely increased benefits to regulated entities in terms of ease and cost of carrying out AML due diligence; and to those who engage with the company in terms of having more information about the real company owners and controllers.	Possibility of increased public sector costs if arrangements are significantly more complex (e.g. different access regime for different data fields) which could be passed on to industry in the form of increased fees. Potential for increased cost to industry through obtaining additional information; possible increases to individuals overall in terms of them being required to provide information to companies when they might otherwise not have needed to provide any (because it is already held by the company).
Requiring companies to update beneficial ownership information held at Companies House as it changes	Likely additional benefit to Government through having more up to date information. Corresponding increased benefits to individuals and business as a result in terms of potential crime impacts. Likely increased benefits to regulated entities and those who engage with the company in terms of having more up to date information about the beneficial owners.	Possibility of increased public sector costs if number of changes to be administered increases significantly, which could be passed on to industry in the form of increased fees. Likely increased costs to some companies, potentially same or lower costs to companies whose beneficial ownership changes less than annually. The IFF survey (adjusted as per the other costs) suggests that these could be in the region of £9 per company. The same caveats as above should be applied to this figures.

Title: Transparency and Trust –Corporate Directors **IA No:** RPC13-BIS-1988 **Lead department or agency:** Department for Business, Innovation & Skills Other departments or agencies: HM Treasury, Home Office, Ministry of Justice; Insolvency Service, Companies House; Law enforcement agencies	**Impact Assessment (IA)** **Date:** 16 April 2014 **Stage: Consultation** **Source of intervention:** International **Type of measure:** Primary legislation **Contact for enquiries:** Transparency and Trust Team Tel: 0207 215 1848 Email: Transparencyandtrust@bis.gsi.gov.uk

Summary: Intervention and Options

RPC Opinion: Amber

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, Two-Out?**	**Measure qualifies as**
-£37.45m	-£37.4m	£3.58m	No	N/A

What is the problem under consideration? Why is government intervention necessary?

Opacity of the control of corporate structures can firstly facilitate illicit activity, and secondly lead to a deficiency in corporate governance which erodes trust and damages the business environment. Both can ultimately hold back economic growth. Government intervention is necessary both to correct the regulatory failure underpinning the first, and the information asymmetry reflected in the second. Corporate directors – one company (or legal person) as the director of another – are inherently opaque with respect to the individuals (or natural persons) in fact controlling a company. The central problem under consideration is therefore the scope for abuse and mistrust in the current legal framework which provides for the appointment of corporate directors.

What are the policy objectives and the intended effects?

The policy objective is to reduce corporate opacity in the UK, particularly where corporate opacity arises as a result of the use of corporate directors. In restricting the use of corporate directors, the government is seeking to reduce the potential for abuse of the company structure for purposes such as laundering money and to realise the benefits of trusted capitalism to support the business environment. The intended effect is a proportionate and effective system which deters illicit activity and promotes good corporate behaviour.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Two substantive options are considered in this Impact Assessment. We did consider the scope for alternatives to regulation, but these did not meet the policy objectives since those currently benefitting from opacity for illicit activity would be impervious to them, and were complicated by the fact that the current regime is set out in statute and changing it requires legislation. The first substantive option involves the complete prohibition of the use of corporate directors for UK incorporated companies. This has higher costs to business than the other options. The second substantive, and preferred, option considers a prohibition of corporate directors (in primary legislation) as the default position, with exemptions (set out in regulations). These exemptions would be varied at the discretion of the Secretary of State (and subject to the will of Parliament), but illustrative scenarios are provided on the basis of exemptions relating to areas of high transparency, regulation and disclosure, and high current use of corporate directors to derive economic efficiency.

Will the policy be reviewed? It will be reviewed, pending determination of appropriate timeframes with respect to passage of primary legislation (eg within 5 years of coming into force).					
Does implementation go beyond minimum EU requirements?			N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** Yes	**< 20** Yes	**Small** Yes	**Medium** Yes	**Large** Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** N/A	**Non-traded:** N/A	

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed by the responsible Minister: .... Date: 5 March 2014

Summary: Analysis & Evidence Policy Option 3 – **not preferred**

Description: Complete prohibition of corporate directors

FULL ECONOMIC ASSESSMENT

Price Base Year 2013	PV Base Year 2013	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -453.13	**High:** -23.01	**Best Estimate:** -39.05

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	23.0		0	**23.0**
High	453.1		0	**453.1**
Best Estimate	39.1			**39.1**

Description and scale of key monetised costs by 'main affected groups'

Companies which currently use corporate directors would incur costs in complying with a new system which involves a complete prohibition of corporate directors. For these companies, the costs would come from familiarisation with the policy change (staff time totalling around £14m) and the replacement of a corporate director, should the company decide to pursue that course (staff time totalling around £25m). There would also be costs to government to publicise and implement the relevant regulatory changes (totalling £51,500).

Other key non-monetised costs by 'main affected groups'

Companies currently using corporate directors would incur costs in complying with a new system which cannot be monetised. These would include costs resulting from any disruption, reputational damage or loss of benefits after corporate directors are prohibited and removed. In terms of forgone efficiency, costs relating to a loss of current benefits would also be ongoing to future companies, which would have benefitted from the use of a corporate director. We have used qualitative data from a company survey to understand the potential advantages companies derive from using corporate directors, and therefore to understand the range of potential costs associated with the prohibition of their use.

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low				
High				
Best Estimate				

Description and scale of key monetised benefits by 'main affected groups'

The benefits derived from this policy change cannot be fully monetised due to they way law enforcement and crime data are recorded. Please see below for description of non-monetised benefits.

Other key non-monetised benefits by 'main affected groups'

The benefits derived from the complete prohibition of corporate directors would accrue to the government, business and individuals from a reduction in crime. Law enforcement agencies would derive benefits from simpler investigations; the public would benefit from lower levels of crime; and business as well as the public would benefit from the positive effects of reduced crime on economic growth. We have used the best available evidence to demonstrate the possible costs of financial crime, and therefore the potential benefits from reducing it. Benefits for business would also be derived from improved trust and a more transparent environment which facilitates transactions and supports economic growth.

Key assumptions/sensitivities/risks **Discount rate (%)** 3.5

Almost by definition, corporate opacity is challenging to evaluate; we have taken considerable steps to identify material to support quantification of the costs and benefits of the proposals, and have used evidence derived from a survey of 600 companies. We received a large number of both high and zero cost estimates in the survey so the sample was truncated to arrive at more robust and representative estimates. We have also conducted some sensitivity analysis around our estimates.

BUSINESS ASSESSMENT (Option 3)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs: 3.7	**Benefits: 0**	**Net:** -3.7	NO	N/A

Summary: Analysis & Evidence Policy Option 4 – **preferred**

Description: Prohibition of corporate directors with specified exemptions

FULL ECONOMIC ASSESSMENT

Price Base Year 2013	PV Base Year 2013	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -432.6	**High:** -22.13	**Best:** -37.45

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	22.1			**22.1**
High	432.6			**432.6**
Best Estimate	37.5			**37.5**

Description and scale of key monetised costs by 'main affected groups'

Companies which currently use corporate directors and are not eligible for an exemption from a future prohibition would incur costs based on familiarisation with the policy change (staff time totalling around £13m) and the replacement of a corporate director, should the company decide to pursue that course (staff time totalling around £24m). These costs will occur to a lesser extent for those companies within the scope of exemptions, and therefore the total costs are lower. There will also be costs to government to publicise and implement the relevant regulatory changes (totalling £51,500).

Other key non-monetised costs by 'main affected groups'

Companies which currently use corporate directors and are not eligible for an exemption from a future prohibition would incur costs in complying with a new system which it is not currently possible to monetise (as set out with respect to option one). These costs would, however, occur to a lesser extent for those companies within the scope of exemptions, and therefore the total costs are lower. We have used qualitative data from a company survey data to understand the potential advantages companies derive from using corporate directors, and therefore to understand the range of potential costs associated with the prohibition of their use.

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate				

Description and scale of key monetised benefits by 'main affected groups'

The benefits derived from this policy change cannot be fully monetised due to they way law enforcement and crime data are recorded. Please see below for description of non-monetised benefits.

Other key non-monetised benefits by 'main affected groups'

The benefits derived from the prohibition of corporate directors with a more restricted number of companies in scope, will deliver benefits for the government, business and individuals from a reduction in crime (as per option one). Benefits for business will also be derived from improved trust and a more transparent environment which facilitates transactions and supports economic growth, again as per option one. Relative to option one this option retains the efficiency benefits for companies which use corporate directors in key categories.

Key assumptions/sensitivities/risks **Discount rate (%)** 3.5

Almost by definition, corporate opacity is challenging to evaluate; we have taken considerable steps to identify material to support quantification of the costs and benefits of the proposals, and have used evidence derived from a survey of 600 companies. We received a large number of both high and zero cost estimates in the survey so the sample was truncated to arrive at more robust and representative estimates. We have conducted some sensitivity analysis around our estimates.

BUSINESS ASSESSMENT (Option 4)

Direct impact on business (Equivalent Annual) £m:			**In scope of OITO?**	**Measure qualifies as**
Costs: 3.6	**Benefits:** 0	**Net:** -3.6	No	NA

Executive Summary

Problem under consideration and rationale for intervention

- At the G8 Summit in 2013, the G8 Leaders recognised the problem of corporate opacity and agreed to publish national Action Plans setting out the concrete steps they would take to address this. The UK's Action Plan set out a number of commitments, including commitments in relation to opacity around company directors.
- Corporate opacity can facilitate illicit activity, and can lead to poor corporate oversight which erodes trust and damages the business environment. Both crime and a lack of trust can impede economic growth.
- The use of corporate directors, whereby one company (or other legal person) acts as the director of another, creates corporate opacity with respect to the individual (natural person) controlling a company. It could also lead to reduced effectiveness of corporate oversight.
- In total, there are around 67,000 companies with corporate directors in the UK. Notably, despite being limited to 2.1% of all companies, corporate directors feature in many cases of financial crime (for instance, around one quarter of all Serious Fraud Office cases).
- There is a dual rationale for government intervention to address the problems of corporate opacity. Where there is a lack of transparency around corporate structures which facilitates illicit activity and hinders the criminal justice system, there is **regulatory failure** with respect to the company law framework and enforcement. Where there is a lack of transparency, there is an **information asymmetry** which damages trust and hinders transactions and investment.
- The central problem under consideration is therefore the scope for abuse and mistrust in the current legal framework which provides for the appointment of corporate directors.

Policy Objectives and Options

- The overarching policy objectives for the *Transparency and Trust* package are to reduce crime and improve the business environment so as to facilitate economic growth.
- More specifically, the policy objective is to reduce corporate opacity in the UK, particularly where corporate opacity arises as a result of the use of corporate directors. In doing so, the UK will seek to meet its international obligations and promote positive action towards corporate transparency on an international stage.
- By restricting the use of corporate directors, government is seeking to reduce the potential for abuse of the company structure for purposes such as laundering money, realise the benefits of trusted capitalism to support the business environment, and simultaneously minimise any effects on legitimate business resulting from the policy change.
- The options considered to achieve this objective included
    - A 'do nothing' option. This does not meet the policy objectives.
    - Alternatives to regulation, including the voluntary provision of information in relation to individuals within corporate director companies (companies acting as corporate directors). This also does not meet the policy objectives since those using corporate opacity to facilitate illicit activity would be impervious, and the approach is complicated by the fact that the current regime is set out in statute and changing it requires legislation.
    - Option one. A complete prohibition of corporate directors
    - Option two (the preferred option). A prohibition of corporate directors (in primary legislation) with exemptions from the prohibition (set out in regulations). These exemptions could apply to those companies which are subject to wider transparency requirements or regulation, and those which commonly benefit from the use of corporate directors.

Costs and benefits

- **Option one** delivers a range of benefits which cannot be monetised, derived from a reduction in crime and an increase in trust, both of which are factors supporting an environment for growth. It delivers a range of costs on business to comply with the new requirement, largely restricted to those companies which currently have corporate directors. These costs total £39m, which consists of approximately £14m in familiarisation costs; approximately £25m costs incurred by companies in removing and replacing prohibited corporate directors and just over £51,500 in costs to government enacting the changes. This gives an EANCB of £3.7m.
- **Option two, which is the preferred option,** delivers a broadly equivalent range of non-monetised benefits to option one. Since option two requires change of fewer companies (where those companies are carefully determined in relation to the likelihood of legitimate use of corporate directors, the same benefits can be delivered at reduced cost to business). These costs total £37m, which consists of approximately £13m in familiarisation costs; approximately £24m costs arising due to companies removing and replacing prohibited corporate directors; and just over £51,500 in costs to government enacting the changes. This gives an EANCB of £3.6m.
- These costs and benefits described here are based on the most robust and up to date analysis available. We will seek to develop the analysis further for the final stage Impact Assessments relating to this package.

Background

A lack of corporate transparency

1. Under the Presidency of the UK, G8 Leaders agreed at Lough Erne in June 2013 that a lack of corporate transparency was a problem they were determined to address. They described it thus :
   "A lack of knowledge about who ultimately controls, owns and profits from companies and legal arrangements, including trusts, not only assists those who seek to evade tax, but also those who seek to launder the proceeds of crime, often across borders. Shell companies can be misused to facilitate illicit financial flows stemming from corruption, tax evasion and money laundering. Misuse of shell companies can be a severe impediment to sustainable economic growth and sound governance. We will make a concerted and collective effort to tackle this issue and improve the transparency of companies and legal arrangements. Improving transparency will also improve the investment climate; ease the security of doing business and tackle corruption and bribery. It will support law enforcement's efforts to pursue criminal networks, enforce sanctions, and identify and recover stolen assets. We are determined to take action to tackle the misuse of companies and legal arrangements."

2. The G8 Leaders each agreed, and have now published, national Action Plans setting out the concrete steps they would take to address the misuse of companies. The UK's Action Plan set out the intention to review corporate transparency, including the role of directors. It committed to "improve the transparency of the ownership and control of companies and legal arrangements [since] this is a matter of good corporate governance as well as a means to tackle a wide range of illicit activity."

3. The G8 documents therefore explain the importance of solving the problem of a lack of corporate transparency, and also explained the context for the inclusion in scope of the role of directors and those who control them[109].

4. In July 2013, the Department for Business, Innovation and Skills (BIS) published its *Transparency and Trust* discussion paper. In it, we considered a range of proposals to enhance the transparency of UK company ownership and increase trust in UK business; including implementation of the UK's G8 commitment to create a central registry of company beneficial ownership information. As set out in the paper, *"Business success – and therefore economic growth – depends on investors, employees, consumers and wider public having confidence in business. When companies do business with each other, those transactions must also be built on trust.[110]"*

5. This Impact Assessment concerns opaque arrangements involving company directors, specifically the use of corporate directors (where one company or other legal person acts as the director of another). Other Impact Assessments, published in parallel or forthcoming, cover other proposed action to improve the transparency of ownership and control of companies; taken together, these measures should meet the G8 objectives to tackle the misuse of companies. Other Impact Assessments, published in parallel or forthcoming, cover measures to increase the accountability of the directors or others involved in companies, which will help achieve the wider *Transparency and Trust* objectives.

109 A company can be controlled by its directors, by those with an interest in its shares, or by those who control it in some other way. The UK Action Plan covers all forms of control overall, including control of a company through its directors, and refers to 'nominee directors' as an over-arching term. In practice, control can be concealed through use of a company acting as a director – a corporate director – as described in this Impact Assessment. Alternatively, a 'front' individual can be registered as a director to conceal real control.

110 Transparency and Trust BIS, July 2013 https://www.gov.uk/government/consultations/company-ownership-transparency-and-trust-discussion-paper.

Problem Under Consideration

6. The G8 commitments also capture the two sides of the problem under consideration – firstly the problem of opacity facilitating illicit activity, and secondly that of a deficiency in corporate governance eroding trust and damaging the business environment. Both problems can ultimately hold back economic growth.

Corporate transparency – reducing potential for illicit activity

7. As an indication of the scale of this type of criminal activity, the European Commission's 2013 Impact Assessment of 'Anti-Money Laundering and Terrorist Financing'[111] points to United Nations[112] estimates of global criminal proceeds amounting to some 3.6% of GDP; around US$2.1 trillion in 2009. Using this analysis, the best available international estimate of the amounts used in money-laundering would be equivalent to some 2.7% of global GDP or US$1.6 trillion in 2009[113].

8. Illicit financial flows reflect and result in significant global challenges; illicit flows out of low income countries, particularly in Africa, are sizeable. It is often said that these countries lose billions of dollars per year through illicit financial flows. Though almost by definition figures are difficult to derive, the Africa Progress Panel chaired by Kofi Annan[114] highlighted the problem, citing research suggesting that the annual loss to Africa between 2008 and 2010 was $38bn, and that between 1970 and 2008 $1.8 trillion were lost from the continent - with obvious human consequences[115]. Moreover, as the Government's Serious Organised Crime Strategy[116] sets out, "overseas, organised crime undermines good governance and the stability of countries of strategic importance to our national security. Organised crime groups overseas can facilitate or engage in terrorism." Reducing the potential for illicit financial flows, including through abuse of the company structure, is therefore one means of countering significant international problems.

9. There is a clear link between such illicit financial flows and company structures, described with concern by a range of international expert organisations. The Organisation for Economic Co-operation and Development (OECD)[117] has observed that "almost every economic crime involves the misuse of corporate vehicles [ie companies]." A World Bank review[118] of 150 cases of grand corruption identified the use of companies in the majority, including some UK companies. Meanwhile, the World Economic Forum (WEF)[119] highlighted the increasing number of problematic cases confronting law enforcement agencies involving illegitimate business activity co-mingling with legal business activity, and illegitimate funds with licit funds.

10. These issues are systemic and relate in many ways to the essence of the company form, which is largely replicated throughout international legal systems. Given the significant international issues, and the high profile association of some jurisdictions with illicit financial flows, the UK is driving

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111 *Impact Assessment : proposal on the prevention of the use of the financial system for the purpose of money laundering, Including terrorist financing.* European Commission (2013; for revision of the third money laundering directive)

112 *Estimating illicit financial flows resulting from drug trafficking and other transnational organized crimes: Research report*. (October 2011)UNODC

113 This money laundering estimate would be within the IMF's original 'consensus range', equivalent to some 2.7 per cent of global GDP (2.1 – 4 per cent) or US$1.6 trillion in 2009.

114 *'Africa Progress Report 2013: Equity in Extractives'* (2013) Africa Progress Panel

115 *'Illicit Financial Flows from Africa: Hidden Resources for Development'* (2013) Global Financial Integrity and the African Development Bank

116 *Serious Organised Crime Strategy* Home Office (October 2013). The £24bn cost excludes money laundering.

117 *Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes* (2011) OECD

118 *The Puppet Masters : How the Corrupt Use Legal Structures to Hide Stolen Assets and What to do About It.* (2011) World Bank Publications

119 *Organised Crime Enablers* (2013) World Economic Forum *"Law enforcement agencies have been handling an increasing number of cases in which legitimate businesses co-mingle with illegal businesses, and legitimate funds with illicit funds. Reconstructing these complex corporate schemes and identifying who lies behind them, i.e. identifying their beneficial owners (BO), is considered to be essential to reveal the full extent of the criminal infrastructure and to prevent future criminal activities."*

change on a wider stage. The Government is pursuing this not only through the G8, as mentioned, but also in the G20, in the Financial Action Task Force (FATF), in Europe and with the UK's Overseas Territories and Crown Dependencies. In parallel, there is a strong case for domestic action to reduce the vulnerability of the company form.

11. With respect to the UK, directly applying the 2009 global estimates as set out above (which may or may not be representative) would equate to around £42 billion of laundered money in 2012. The social and economic costs of organised crime in the UK are estimated to be £24bn[120], of which £8.9bn are associated with fraud. The abuse of the company structure described as a general principle above applies equally in the UK and contributes to our issues as it does internationally.

12. In 2011, the Financial Services Authority[121] (in their role now assumed by the Financial Conduct Authority) published an assessment of how banks manage money laundering risk including where it arises from the use of UK incorporated companies; they described an example where "Company A is a UK incorporated company which has an account with the private banking arm of a major UK group." The bank had determined the ultimate beneficial owner of Company A as "a PEP [politically exposed person] whose husband is a former politician from a higher risk country." In this situation, the bank's processes with respect to the company led it to terminate the relationship.

13. This connection between crime and the company structure can be demonstrated yet more vividly by recent examples. Within one month of the G8 Summit, eight people were found guilty following an investigation by North Yorkshire Police's Major Fraud Investigation Team and Her Majesty's Revenue and Customs (HMRC) which showed the use of a series of companies to launder the proceeds of a £1.28m theft from the Department for the Environment, Food and Rural Affairs (DEFRA) and attempt a £250,000 VAT fraud122. Earlier in 2013, two people were found guilty, following an investigation by the Serious Fraud Office (SFO), of using deception and forgery including the use of company structures to perpetrate a fraud worth millions of pounds[123].

14. On the basis of the current opacity and abuse of the company structure, a strong case for action to increase corporate transparency has been made by the UK's law enforcement agencies. The SFO, the National Crime Agency (NCA)[124], the Crown Prosecution Service (CPS), HMRC and various branches of the police have been engaged in the development of the package and this Impact Assessment and have described the problems the *Transparency and Trust* package could address and the benefits it could bring for them, and crucially for business and the public from a potential reduction in crime.

15. Law enforcement agencies have reported the impact of corporate opacity as a whole, engineered through various means, on their investigations. With respect to corporate directors specifically, the SFO estimate they are involved in around one quarter of their cases, with the need for action reinforced by further substantiations from the NCA, HMRC and the police. Moreover, the evidence from law enforcement reflects how commonly corporate directors are used for criminal purposes given that only 2.1% of UK companies actually have corporate directors on their boards.

16. In practical terms, the use of a corporate director stymies their investigations with opacity, simply making it more expensive and less likely that they will be able to identify natural persons in whom they are interested. Moreover, current case law prevents the successful prosecution of the

120 *'Serious and Organised Crime Strategy' (*October 2013) Home Office. These estimates exclude money laundering.
121 *Banks' management of high money-laundering risk situations* June 2011 FSA. FSA functions now undertaken by the FCA.
122 http://www.northyorkshire.police.uk/11613
123 http://www.sfo.gov.uk/press-room/latest-press-releases/press-releases-2013/achilleas-kallakis-and-alexander-williams-jailed.aspx
124 NCA and previously the Serious Organised Crime Agency (SOCA) ; some evidence was provided by the Serious Organised Crime Agency prior to the launch of the National Crime Agency in October 2013.

individual natural person directors behind corporate directors because of the legal distinction between the corporate director company and its directors. HMRC recently lost a case in which it was made clear by the courts that taxes owed to the crown could not be recovered from the individual directors of a company acting as a corporate director[125].

Corporate Transparency – improving corporate governance

17. *"High quality corporate governance helps to underpin long-term company performance. The UK has some of the highest standards of corporate governance in the world, which makes the UK market attractive to new investment."* This widely held view has been captured here by the Financial Reporting Council, the UK's independent regulator responsible for promoting high quality corporate governance and reporting to foster investment. But keeping the UK's position secure requires continual evaluation of improvements that can be made.

18. Where the director of a company is not an individual but another company, there may be reduced scope for effective corporate governance and valuable oversight and management of the company. Directors have clear duties and functions set out in law that many have argued during our consultation are in many cases best assumed by an accountable individual. It is noteworthy also that the Parliamentary Commission on Banking Standards emphasises individual accountability in its recommendations, approaching the issues from a different angle[126].

19. We are therefore seeking to determine an effective means of maximising the oversight and accountability of company directors to support effective functioning of companies.

Current UK legal regime around corporate directors

20. Much of the UK's regime around companies and company directors is set out in primary legislation. Before the Companies Act 2006, companies could appoint other companies (or other legal persons) as directors without restriction. Currently, as set out in the Companies Act 2006, corporate directors are permitted alongside a requirement for company boards to appoint at least one director who is an individual (a 'natural person'). The provision of at least one natural person director to be accountable is of no value, under current case law, in prosecuting cases when it is the individuals behind the corporate director who are at fault, and there is therefore a problem embedded in the current legal framework.

21. Limited Liability Partnerships (LLPs) are another class of corporate structure in the UK which, though not companies, are subject to many of the provisions in the Companies Act (applied to them by regulation). They appoint 'members,' and under the current regime can appoint corporate members without restriction; there is no requirement for at least one member to be a natural person.

22. It is worth noting that the governments of several civil and common law jurisdictions have already intervened to address the problem by removing the use of corporate directors entirely. These include but are not limited to Germany, Canada and Australia.

Current use of corporate directors

23. Around 67,000 companies and LLPs currently have corporate directors on their board (or corporate members in the context of LLPs). This represents around 2.1% of all active and dormant UK

125 *Holland v The Commissioners for Her Majesty's Revenue and Customs and another* [2010] UKSC 51.
126 *Changing Banking for Good* (June 2013) Parliamentary Commission on Banking Standards

companies. It is also of note that around 29,000 of the 67,000 are LLPs, which represents over half of all LLPs. Around half of this number, over 14,000 LLPs, have corporate members only with no natural persons.

24. Since implementation of the changes in the Companies Act 2006, requiring at least one natural person director of a company (though not of LLPs), the use of corporate directors has been in decline. In 2005 there were around 80,000 appointments but by 2012 this had fallen to around 1,800. Interestingly, the IFF company survey[127] indicated that 31% of the companies which did have corporate directors on their board saw no advantage to having one present. Combined with the fact that many jurisdictions do not allow corporate directors, this suggests it is possible for companies to find alternative means of managing their processes which do not involve corporate directors.

25. There remains, however, a stock of 100,200 corporate directorships in the UK, which we are considering here.

26. Companies House data indicate that over 85% of the 67,000 companies with corporate directors file accounts as if they were small companies[128]. It should be noted that *large* companies might reasonably be thought to pose a lower risk of being used as a shell company for illicit activity (since larger companies might be more likely to be employing staff and producing goods, while those seeking to use a company as a vehicle for illicit ends need only establish a small one to do so). At the same time, large companies in group structures might be more likely to gain business benefits, for instance efficiency, from the use of corporate directors[129].

27. Circumstances where corporate directors are used to increase efficiency often coincide with situations of extensive regulation and transparency and high standards of corporate governance. For instance, it is common for charities to use corporate directors, which was noted by respondents to our consultation. The problem therefore warrants a solution which is workable for business, and proportionate.

The problem - and a route to a solution

28. The central problem under consideration is therefore addressing the scope for abuse in the current legal framework which provides for the appointment of one company (or legal person) as the director of another.

29. The aim is to limit the use of corporate directors in the UK to reduce the potential for abuse, realise the benefits of trusted capitalism, and minimise any costs to business of the change (through considering carefully which businesses should change, and what will be required of them in doing so).

30. To support the development of solutions, BIS set out the issues and some key questions around potential options for action in the *Transparency and Trust* discussion paper. Views on the paper were provided formally by a range of interested people and parties between July and September 2013.

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127 BIS/IFF company survey 2013 (see costs sections and Annex A).
128 The proportion of small companies may be higher because they have the option to file full accounts, which would make them appear 'large' in terms of accounts type (i.e. we assume companies which file abbreviated accounts are 'small' but some small companies file full accounts so will not be counted). This calculation includes accounts that were 'not filed', which generally includes new companies in their first 24 months.
129 See also Small and Micro Business Assessment in Wider Impacts section.

31. The paper covered not only proposals with respect to corporate directors, but also obscuring of the identity of a director through other opaque director arrangements, including controlling an individual director who acts as a ‘front,’ and the implementation of a central register of company beneficial ownership information and options to restrict the use of bearer shares. It also included a range of potential actions to tighten the enforcement regime for disqualifying company directors who break the rules. These measures should be considered very much as a package.

32. Following consultation, the preferred option involves restricting the use of corporate directors to areas defined by the Secretary of State (subject to the will of Parliament) where he judges there are legitimate reasons for their use which give business benefit, coupled with a low risk of their abuse.

33. We have also considered non-regulatory options to address the problem under consideration, that have not been assessed for the purposes of this Impact Assessment since they were determined unlikely to meet the policy objectives.

34. There are non-regulatory techniques for crime prevention and reduction, as outlined in the Home Office’s Serious and Organised Crime Strategy[130], for example, education and communications strategies to raise awareness of the impacts of serious and organised crime. However, a key element of that Strategy relates to “prosecuting and disrupting serious and organised crime”. This often necessitates a regulatory approach – regulatory requirements to make it more difficult for criminals to operate and regulatory sanctions to allow prosecution and disrupt criminal activity (e.g. by imprisoning offenders, thereby preventing further criminal activity). In the context of corporate transparency, law enforcement agencies have endorsed the importance of a regulatory approach, highlighting the potential to deter and disrupt criminal activity.

35. It is possible that enhanced transparency – albeit voluntary - may ultimately deter some companies who would otherwise have chosen to conduct illicit activity through incorporating a company in the UK. However, it is not possible to estimate this impact, particularly as it would be contingent on the action other jurisdictions take in this sphere (i.e. whether they do more or less than the UK). Ultimately, we anticipate that a non-regulatory approach would not contribute to reduced levels of crime as companies engaged in criminal activity would simply opt to ignore any such moves (for example an information campaign). Were there an option, for instance, to provide information relating to individuals within corporate director companies, those for whom opacity is an advantage for their illicit activity would not be likely to provide it.

36. With respect to perceptions, it is likely that voluntary options would diminish the UK’s standing with respect to encouraging change from other jurisdictions and engaging with them on an operational basis, and it seems to put in jeopardy the benefits that UK business stand to gain from a transparent and ‘clean’ business environment in the UK.

37. More specifically, one such non-regulatory option might have included the voluntary provision of the name of an individual within the name of a company acting as a corporate director. However, it was considered that this would have limited effect, placing these individuals in an ambiguous situation legally with respect to their duties and liabilities, and unlikely to capture those seeking to take advantage of opacity.

38. A further option would have been a campaign to promote the use of natural person directors, but again this was considered likely to be ineffective, and potentially perceived as ambiguous since

130 HMG, 2013: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/248645/Serious_and_Organised_Crime_Strategy.pdf

corporate directors are permitted in statue and so much of the landscape in which companies operate is set out in primary legislation. While we are, elsewhere in the policy package, taking forward proposals to communicate directors duties and liabilities to them more effectively, with respect to corporate directors this assessment of alternatives to regulation in fact spoke to the value of various legislative options as discussed below.

39. **The problem of opaque company ownership structures can therefore be summarised as increasing the potential for criminal activity and potentially also reducing levels of trust in business. Without Government intervention, there is unlikely to be sufficient collective action by industry to address these issues, particularly given the criminal nature of the activity we are aiming to address.**

Rationale for intervention

40. There are two facets to the economic rationale for Government intervention through the policy changes described here. Firstly there is the **regulatory failure** associated with the current corporate governance and company law frameworks, which enables some individuals who control companies to remain anonymous and hence allow or even facilitate financial crime. Secondly, and linked to that, there is an **information asymmetry** with respect to company ownership and control, between those that control companies and those that trade with them or invest in them, which inhibits economic activity. The inefficiency and reputational damage that crime introduces to the economy, as well as the lost business and reduced investment from information asymmetry, could all negatively impact on economic growth.

Regulatory failure and the potential facilitation of crime

41. There is a well-established role for the State in addressing criminal behaviour. This includes the introduction of laws which form a central part of the UK's institutional infrastructure and business environment. By upholding the law and enforcing property rights, the State facilitates economic activity. The State's role also includes the provision of criminal investigation and law enforcement, not least where there are externalities and the potential for free-riding. It could be argued that there is a regulatory failure where there is a deficiency in the legal framework, or in the functions of associated institutions, which facilitates crime (which in turn imposes costs on society). There is therefore a clear rationale for intervention where the net benefits of government action outweigh the cost of inaction.

42. Companies and other corporate entities have separate legal personality, meaning that they can enter into contracts and business relationships in their own name. Importantly, in addition, many companies take advantage of the option to have limited liability for their investors. In exchange for these advantages, which facilitate entrepreneurship[131], a company is required to put additional information in the public domain (eg their accounts, shareholders and directors) compared to other business forms (e.g. sole traders). However there still remains scope for opacity around corporate ownership structures and company control. Various aspects of the current corporate ownership system (e.g. bearer shares, opacity of beneficial ownership, opaque involvement involving directors) can be used to conceal an individual's interest in a company from the authorities. This means that law enforcement agencies cannot readily identify individuals behind/controlling a company and as a result, in some cases, criminal activity can be facilitated.

131 *Entrepreneur Wealth and the Value of Limited Liability,* 2011 Brian Brougham

43. This potential for anonymity means that the individuals who 'stand behind' a company can then use the company as a front to launder the proceeds of crime and to finance organised crime and terrorism[132]. In effect, the corporate structure can be used to help support criminal activity - from the supply of drugs, to fraud and corruption. This anonymity also means that law enforcement agencies cannot always readily identify the individuals really responsible for the criminal activity - resulting in less efficient and effective investigations and potentially sub-optimal outcomes. Where the corporate governance and company law frameworks do not ensure sufficient transparency to prevent this opportunity, and hence also fail to reduce the need for risk mitigation measures by counterparties or inefficient corporate activity, it can be viewed as a **regulatory failure**.

44. Thus, in this case, regulatory failure facilitates crime which can lead to costs to the economy and more widely to society. These costs include the welfare damage to the victim; inefficient resource allocations and a forced redistribution of income; lost economic activity/output; inefficient insurance expenditure; and costs to the criminal justice system, including the police[133]. The aim of this policy to address the regulatory failure affecting corporate ownership and control transparency is to reduce the opportunity for criminal activity and thus reduce these costs to the UK.

45. Opaque corporate structures can not only facilitate crime but also hamper the law enforcement response. Firstly, during the investigation phase where time and resource can be used to establish basic facts, such as who are the individuals owning particular assets or who control a company, and secondly, during prosecution or after a conviction, by preventing confiscation of the proceeds of crime by the authorities and return of assets or compensation to the victims.

46. The use of corporate directors is one important means used to conceal corporate control, and the SFO explained that corporate directors were a feature of around a quarter of their cases. The broad case for action on corporate directors to support law enforcement agencies in reducing crime was reinforced by the SOCA and HMRC.

47. Reducing opportunities for crime could help support conditions for growth. Each US$1 billion laundered reduced overall economic growth by 0.04-0.06 percentage points in 17 OECD countries, prompting the UN to comment on the findings that "financial centres have developed a self-interest of not being associated with 'tainted money' and have signed relevant international instruments to avoid the inflow of such criminal finance.[134]"

48. There is a strong body of evidence highlighting how crime acts as a drag on investment, job creation and ultimately economic growth. For instance, Goulas and Zervoyianni (2013)[135] find that in times of macroeconomic uncertainty, a 10% increase in the crime rate is associated with a reduction in annual GDP per capita growth of 0.49%-0.62%. Although these studies[136] do not directly identify the mechanism, they highlight that reducing crime is thought to support growth.

132 That is to say, the money passing through the company can be of criminal origin, and / or can be used to support further crimes. Through the anonymity of the company structure the individuals involved can be concealed.
133 See Brand and Price (2000) "*The economic and social costs of crime*". Home Office Research Study 217 and
The economic and social costs of crime against individuals and household" 2003/04. Dubourg et al (2005) Home Office Online Report 30/05.
134 *Estimating illicit financial flows resulting from drug trafficking and other transnational organized crimes: Research report.* (October 2011) UNODC
135 *Economic growth and crime: does uncertainty matter.* Goulas and Zervoyianni (2013) Applied Economics Letters, Vol 20, issue 5, pp420-427)
136 See also Detotto and Paulina (2013) *Does more crime mean fewer jobs and less economic growth?* European Journal of Law and Economics, Vol 36, Issue 1, pp183-207 and Detotto and Otranto (2010) *Does crime affect economic growth* International Review of Social Sciences, Vol 63, Issue 3, pp330-345.

Imperfect/asymmetric information affecting the operation of the business environment

49. Opaque corporate ownership structures are also associated with **imperfect/asymmetric information**. In all economic transactions, one party to the transaction must acquire information about the other party to understand sufficiently the quality and risks associated with the goods, service or investment opportunity on offer. In particular, when engaging in high cost and long term economic relationships involving complex goods ("experience" or "credence" goods), services or investments (e.g. long term investment in corporations or purchasing high-end professional services), the information asymmetry between parties is likely to be large and significant.

50. The corporate form helps mitigate the impact of information asymmetry. This is because the company has separate legal personality: *"As a separate legal entity […] the company must be treated like any other independent person with rights and liabilities appropriate to itself*[137]*."* In other words, a person can ideally engage with the company without needing to satisfy himself or herself of the nature of the persons *behind* the company - they simply need to be satisfied with the 'credentials' of the company itself, which is evidently a less onerous and more efficient process than needing to satisfy themselves with respect to all the individuals who might be associated with a company in various ways.

51. Knowledge of a company and its owners is therefore important in helping those who engage with a company to more accurately assess the risk of company transactions, and therefore their own engagement with them. Not knowing who ultimately owns/controls a company means that there is a greater inherent risk of making sub optimal investments, not being paid correctly for goods/services or inadvertently financing crime. This makes economic transactions/activities less attractive[138] and hence less likely to go ahead or they will go ahead but at a higher cost or lower level. For instance, Easley and O'Hara (2004)[139] find that companies which keep a greater proportion of their information private require a greater compensating return for the lack of transparency, i.e. they face a higher cost of capital. This is a common finding in the economic literature[140].

52. Also when corporate information is not readily available, other parties must incur greater costs from conducting due diligence to mitigate this risk. They must, for instance, actively seek to determine the trustworthiness of the company and also write, complete and monitor contracts[141]. Therefore a lack of information will increase transaction costs, which can serve as a serious barrier to entry in the market, discouraging economic activity and harming growth.

53. Whilst both the higher cost of capital and greater risk mitigation represent a market response to a lack of information, they can also be inefficient. This raises the question of why all companies do not volunteer such information proactively. One possibility is that individual's rationality is bounded[142] by the information they have, the finite amount of time at their disposal and limits to their ability to process and analyse all the information available. It is plausible that even though information about the business advantages of corporate transparency exists, companies may be unaware of it. Alternatively, the costs of identifying, accessing, understanding and applying this

137 *Company Law* Hannigan B (2003) B Clays Ltd
138 Furthermore, considering adverse selection, if the share of 'bad' companies exceeds a certain threshold, the market will cease to exist as 'good' companies are driven out of business.
139 *Information and the Cost of Capital* (2004) Easley, D. and O'Hara, M. The Journal of Finance, Vol. 59, No 4.
140 See Barry, C., and S. J. Brown (1985) *Differential Information and Security Market Equilibrium*. Journal of Financial and Quantitative Analysis 20, no. 4: 407-22 for a model, which demonstrates that securities with relatively little information are of a higher systemic risk. See Merton, R. (1987) *A Simple Model of Capital Market Equilibrium with Incomplete Information.* Journal of Finance 42, no. 3: 483-510. Finds that in a model where investors are not aware of all stocks available i.e. suffer from incomplete information, the equilibrium value of each company is always lower.
141 Nonetheless, knowledge is always imperfect to some extent: as noted by Miller and Whitford (2002)141 without all encompassing contracts, which account for every eventuality, some element of trust is implicit in every business contract.
142 Gigerenzer, Gerd and Selten, Reinhard (2002). Bounded Rationality. Cambridge: MIT Press.

information (e.g. the opportunity cost of a director's time) might outweigh the perceived benefits. Furthermore, evidence may be available only in an abstract sense, and not easily accessible to many companies. Therefore, many companies may not volunteer relevant corporate information in these circumstances. Given that such bounded rationality is a likely to be pervasive, firms behaving in this way (i.e. not revealing relevant corporate information) would not necessarily be forced out of the market by more competitive rivals in the long run, even if we assume that markets are competitive.

54. Opacity could also drive adverse selection[143]. The potential investor/lender/customer/supplier of a company cannot distinguish between a low-risk transaction and a high-risk one because of asymmetric information around ownership and control. Therefore they offer 'average' terms and conditions for that transaction. This means that some mutually beneficial trades will only go-ahead at a sub-optimal quantity, or not at all. Over time, standard economic theory suggests that fewer mutually beneficial trades will take place as fewer high quality offers are put to the market on the supply side and risk averse firms and investors start to opt out of the demand side. A market for 'lemons' is the result[144]. On this basis, a lack of transparency and trust can inhibit optimal economic activity.

55. Finally, there is a broader point around the role of trust in the smooth operation of the economy. The literature commonly identifies a significant and positive relationship between trust and overall economic growth, which emerges because trust motivates innovation, investment and more entrepreneurship[145].

56. Whilst trust alone will not drive growth, but it feeds into the stability of economic systems which are key to economic activity. In terms of its relative importance, Whiteley[146] finds evidence suggesting that social capital, defined as the extent to which people are prepared to co-operate based on interpersonal trust, has a highly significant impact on growth - at least as strong as that of education or human capital. More broadly, enhancing trust will act to improve the prospects, reputation and stability of UK businesses and financial services.

57. Hence, overall, the policy proposals around increasing the transparency of corporate ownership and control have the potential to:
    - reduce crime, by addressing a regulatory failure in the corporate governance and Company Law Frameworks; and
    - reduce the risks around economic activity and increase trust by reducing information asymmetry between those that trade with, or invest in, the company and those that control it.

Policy objective

58. The central problem under consideration is addressing the scope for abuse in the current legal framework which provides for the appointment of one company (or other legal person) as the director of another. The aim is to limit the use of corporate directors in the UK to reduce the

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143 It refers to a market process in which undesired results occur when buyers and sellers have access to different information; the "bad" products or services are more likely to be offered and selected.
144 Akerlof G.A. (1970) 'The Market for "Lemons": Quality Uncertainty and the Market Mechanism' The Quarterly Journal of Economics, Vol. 84, No. 3., pp. 488-500
145 For instance, see Knack S, (2001) 'Trust, associational life, and economic performance', World Bank; Dincer and Uslaner (2010) 'Trust and Growth' ; Knack, Stephen and Paul Zak (2001) "Trust and Growth", Economic Journal, 111(470): 295-321 and Knack & Keefer (1997) ' Does Social Capital Have an Economic Payoff? A Cross-Country Investigation', The Quarterly Journal of Economics, Vol. 112, No. 4, pp. 1251-1288. Bjørnskov (2012) 'How Does Social Trust Affect Economic Growth?' Southern Economic Journal, Working Paper 06-2, shows that trust has a direct impact on schooling, which in turn feeds into the investment rate and ultimately economic growth.
146 Whiteley, P. (2000). "Economic Growth and Social Capital," Political Studies 48, 443-466.

potential for costs of abuse, realise the benefits of trusted capitalism, and minimise any costs to business of the change.

59. The aim is to restrict the use of corporate directors in the UK in a way that reduces the potential for abuse, realises the benefits of trusted capitalism, and minimises any costs to business of the change (through considering which businesses should change, and what will be required of them in doing so, and preserving normal business practice where possible). The chosen option should contribute to the two main objectives of the *Transparency and Trust* package, which are to:

- Reduce crime, and
- Improve the business environment

so as to facilitate economic growth.

60. Following consultation, the central, recommended option restricts the use of corporate directors to areas defined by the Secretary of State (subject to the will of Parliament) where he judges there are legitimate reasons for their use which give business benefit, coupled with a low risk of their abuse. But we considered different options to achieve our objective, as part of a comprehensive package to improve corporate transparency across the UK landscape.

Description of options considered (including do nothing)

Option 0 – Do nothing / Status quo

61. If no action were taken, the use of corporate directors would continue. Under existing legislation, as set out in the Companies Act 2006, UK companies would be able to appoint another company or other legal person as a corporate director, alongside an individual (natural person) director. They would then continue to register their corporate and natural person directors at Companies House[147].

62. Companies who use corporate directors would continue to derive the benefits they must currently derive from this arrangement and Companies House would not be required to spend on the communication and implementation of changes. But, crucially, no benefits in relation to crime reduction or improved corporate governance and their potential positive impact on economic growth would be realised.

63. If action were taken in other areas across the *Transparency and Trust* package which made it harder to conceal corporate control, but not taken to control the use of corporate directors, then there might well be potential for increased use of corporate directors to conceal company control.

64. Moreover, if action were taken in other countries (bearing in mind that several major economies including but not limited to Germany, Canada and Australia have already acted) to control the use of corporate directors, but not taken in the UK, then there could conceivably be costs to the UK from a perceived lack of transparency relative to international norms.

147 See also *Company Filing Requirements Consultation Document* (October 2013, BIS). We have consulted on different sorts and timing of information that companies should provide to Companies House following a Red Tape Challenge process. Analysis of the costs and benefits is provided separately.

Option 1 – Prohibiting the use of corporate directors entirely

65. Prohibiting the use of corporate directors in the UK under all circumstances would give rise to an obverse scenario whereby all company directors are individuals (natural persons). This option would involve alteration through primary legislation of the Companies Act 2006 provision that all companies should have at least one natural person director, to a situation where a company must have all directors be natural persons. This would need to apply to all new directors appointed, and, under transitional arrangements, current corporate directors would need to be removed; where desired, a corporate director could be replaced with an individual to give greater equivalence between different directors on a board and eliminate any extant corporate opacity derived from use of corporate directors within the current UK system.

Option 2 (preferred option) – Prohibiting the use of corporate directors save in defined circumstances

66. This option would again involve the prohibition of corporate directors as the default position but will define where companies could be exempted from the prohibition and could use corporate directors.

67. The details of the exemptions would be determined by the Secretary of State and approved by Parliament. They could therefore evolve. We have scenario for exemptions and highlighted the costs and benefits, such that they could be understood through combination and re-combination in future. For the present purposes this includes the below (please see Annex B for further consideration of these illustrative examples):

- Listed companies on an EU regulated market in large group structures
- Large private companies in group structures
- Charity companies
- Pension funds

Monetised and non-monetised costs and benefits of each option

68. In order to gather evidence of the impact of these proposals on UK businesses, individuals and the public sector, and to inform thinking around policy and implementation, BIS has undertaken a literature review, a call for evidence in a public discussion document, various focus groups, discussions with academics, a self-selection online survey, and a fuller survey using interviews (see Annex A for the methodology). The results from these are used to inform the analysis below. For the final stage Impact Assessment, we will continue to develop the evidence base and our analysis.

Option 1 – Prohibiting the use of corporate directors entirely

Benefits

69. The benefits from restricting the use of corporate directors would arise in two forms: from the reduction in the criminal activity associated with opacity of company control; and from the additional transparency, corporate oversight and accountability which supports the business environment. Both could ultimately lead to better conditions to support economic growth.

B1. Benefits to government, individuals and business of a reduction in illicit activities

70. To identify the economic benefits arising from a reduction in illicit activity, we first quantify the total economic cost of related illicit activity. The proposed policy of prohibiting entirely the use of corporate directors will help to prevent crime by enhancing corporate transparency so catching criminals is both cheaper and easier for law enforcement agencies. Based on our understanding of the impact this policy will have on crime, we derive illustrative estimates of the benefits using a range of assumptions about the scale of the crime reduction.

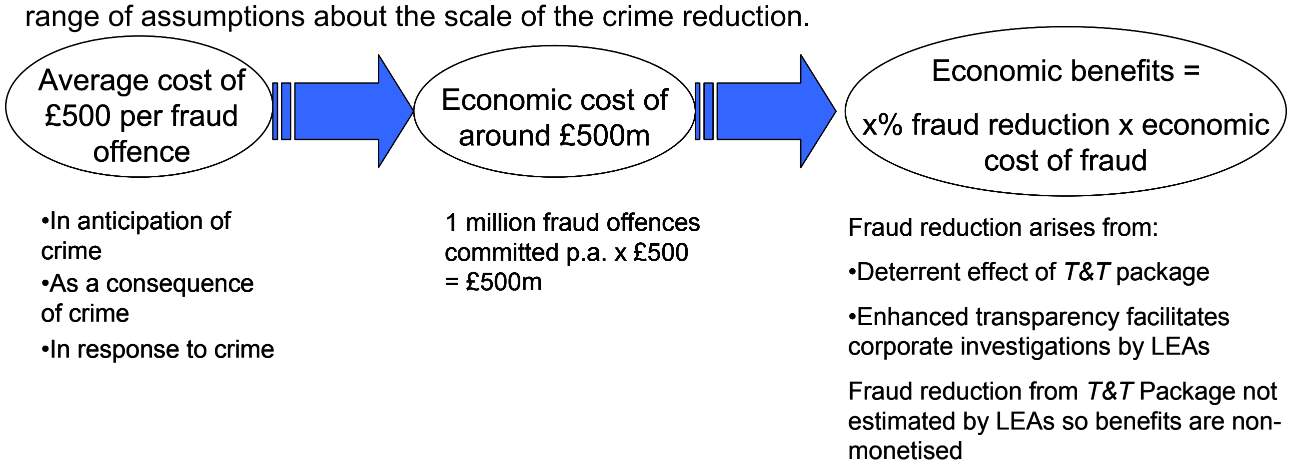

Figure 1: The logic chain behind the benefits of the *Transparency and Trust* package

71. Our consultation with law enforcement agencies revealed support for action across the Transparency and Trust package including with respect to corporate directors, due to the expected reduction in criminal activity. They reported that corporate opacity was a feature of much of the criminal activity they were seeking to combat and reducing it would support a reduction in crime.

Total Economic Cost of Fraud

72. It is not possible to fully monetise the benefits to society from a reduction in crime, or the benefits to law enforcement agencies in terms of reduced costs, in part because of the way in which Law enforcement agencies record their case data. Given the huge scale of any corporate investigation

and the corresponding myriad evidence, there is no systematic distillation of these data such that we can interrogate the impact of a single factor. Indeed, a criminal could conceal his or her identity using a number of, and indeed multiple concurrent, approaches. Nevertheless we have, as set out below, sought to partially monetise the benefits arising from reduced crime of prohibiting front directors.

73. Although law enforcement agency data will not yield a robust estimate of a direct impact on the crime rate due to a removal of corporate directors, the SFO have commented that the overall *Transparency and Trust* package would 'make UK corporate vehicles less attractive to criminals as means to commit fraud or facilitate money laundering,' and that corporate directors probably feature in around a quarter of their cases. The NCA "support[ed] the proposals in the *Transparency and Trust* [discussion] paper, and suggested that "ideally corporate directorships should cease." Other Law enforcement agencies and HMRC have also contributed to our discussions and were similar supportive of the *Transparency and Trust* package.

74. The crime that can be associated with corporate opacity achieved through the use of corporate directors is likely to impose significant direct costs on society. These costs include the physical, financial and emotional damage to the victim[148]; insurance expenditure; lost output; and costs to the criminal justice system, including the police.

75. The economic cost of crime for a full range of offence categories has been estimated by Brand and Price (2000)[149]. We have selected fraud as a key crime on which to focus here; it is a financial crime of the sort that could be facilitated by the use of corporate directors and Brand and Price's fraud data also encompass money laundering. In pulling out this strand for further analysis, we should nevertheless bear in mind the breadth of potential criminal activity linked with opaque corporate structures.

76. Below, we estimate the total economic cost of fraud. This figure is then used to give illustrative examples of the potential economic benefits resulting from crime reduction associated with this policy. Given that law enforcement agencies cannot identify the crime reduction caused by individual policy changes, we have offered illustrative examples to go some way towards estimating the benefits.

77. The estimates Brand and Price use are in turn based on a study by National Economic Research Associates (NERA; 2000). The methodology places a value on the opportunity cost of resources used:
    - in anticipation of crime (e.g. insurance[150] or security expenditure),
    - as a consequence of crime (e.g. to the victim); and
    - as a response to crime (e.g. to the criminal justice system[151]).

148 Economic theory would normally dictate that theft, for instance, is a transfer from one individual to another, but given that the transfer is unwanted and moves the stolen item from the legal economy to the illegal economy, following Brand and Price (2000), we consider this part of the costs of crime. See paragraph 80.
149 The economic and social costs of crime (2000) Brand and Price. Home Office Research Study 217. Although this is not a recent publication it set the standard for robust analysis in this area, and as set out below prices have been adjusted for 2013.
150 Companies might, for instance, purchase fidelity guarantee insurance to protect against fraud by an employee, or crime protection insurance. The Fraud Advisory Panel currently advise small businesses to consider such products, as part of their advice to reduce the impact of fraud on small and medium sized businesses. "Fraud Facts" 2009 https://www.fraudadvisorypanel.org/pdf_show_112.pdfIn a purely economic sense, when an insurance claim is made, it is a transfer. As such 'insurance expenditure' in our estimates only includes insurance administration costs (i.e. the running costs for insurance companies – staff, ICT, property etc) because without crime these costs would be deployed elsewhere in the economy (See Brand and Price (2000) for more detail). Companies might, for instance, purchase fidelity guarantee insurance to protect against fraud by an employee, or crime protection insurance. The Fraud Advisory Panel currently advise small businesses to consider such products, as part of their advice to reduce the impact of fraud on small and medium sized businesses. "Fraud Facts" 2009 https://www.fraudadvisorypanel.org/pdf_show_112.pdf
151 The estimated impact on the Criminal Justice System (CJS) is based on the Home Office 'flow and costs model'. The model estimates the long run costs of a criminal flowing through the system from prosecution and trial to probation or imprisonment. This is based on an active sample of resource costs from staff in the CJS and any associated agencies.

78. We have uprated the average cost estimates for inflation to arrive at estimates in 2013 prices, according to standard HMT GDP deflators[152], and removed the cost of benefit fraud as a conservative step, on the basis this is a subset of fraud less likely to be related to abuse of company structures. This gives us two estimates of the cost per fraud offence of approximately ≈£500 and ≈£1400 in 2013 prices as shown in the table below:

		1999 Cost (£m)	2013 Cost (£m)
Resource Costs	Criminal Justice System (incl SFO)	579	776
	Other public sector	412	553
	Private sector	156	209
Transfer Costs	Public sector	2682	3595
	Private sector	1377	1845
	SFO	1138	1524
Other misallocation of resources (tax distortion)		1858	2490
Number of offences		7.7m	7.7m
Total Economic Cost (Excluding transfers, £m)		3006	4028
Average Cost Per Offence (£) Excluding transfers		≈400	≈500
Total Economic Cost (Including transfers, £m)		8202	10992
Average Cost Per Offence (£) Including transfers		≈1100	≈1400

Table 1: The Economic Cost of Fraud – A Report from the Home Office and Serious Fraud Office (NERA, 2000)
* Average costs have been rounded to the nearest £100 but the original values are used in calculations.

79. The two estimates differ because of the lower figure of ≈£500 excludes transfer costs. A transfer is a redistribution of a good or income from one party to another party such that the recipient's gain exactly offsets the donor's loss and no resources are used. In a pure economic sense, when a criminal steals a victim's property this is a transfer. In reality, however, it is an unwanted transfer, and victims suffer the emotional and physical impact of crime; indeed, the Ministry of Justice 'Criminal Justice System Cost-Benefit Framework' considers the victim's losses but not the offender's gains from crime. Including transfer costs gives a figure of ≈£1400 per fraud offence.

80. We consider ≈£500 as our 'best,' and most parsimonious estimate, while providing the estimate of ≈£1400 for further context as the cost of a fraud offence. While we cannot directly relate a number or proportion of such offences directly to the use of corporate directors, we can estimate, for illustrative purposes, the overall economic cost of fraud, and seek to understand how it might be changed.

81. However, we cannot fully monetise the impact of prohibiting corporate directors because law enforcement agencies could not estimate the proportion of all offences related to corporate directors. For this reason, for illustrative purposes we estimate the *overall* economic cost of fraud.

152 https://www.gov.uk/government/publications/gdp-deflators-at-market-prices-and-money-gdp-march-2013

To arrive at an estimate, we multiplied the average cost of fraud offences by ONS (2013)[153] crime figures. We estimate that there were 1 million fraud offences across the UK in 2012/13[154].

82. On the basis of 1 million fraud offences being committed in 2012/13 with an average cost of ≈£500[155] we estimate that the total economic cost is £523 million, of which £496 million falls on the public sector[156] and £27 million falls on the private sector. This is calculated as follows:

    ≈£500 x 1million = £523m[157]
    Average cost per offence x number of offences

The impact of this policy intervention

83. One might expect that the impact of the *Transparency and Trust* package, which contains a series of targeted measures including the prohibition of corporate directors, would impart a deterrent effect on criminal activity. This could potentially be reinforced by any further deterrent effect law enforcement agencies gain by freeing up additional capacity on the basis of the greater efficiency of their investigations if companies are more transparent. This deterrent effect would also serve to reduce crime and reduce costs for law enforcement agencies.

84. In terms of reduced costs for law enforcement agencies, prohibiting corporate directors would remove a layer of complexity currently facing law enforcement agencies during their investigations in seeking to identify the natural person controlling a company. As a result, investigations could be expedited and more efficient for law enforcement agencies.

85. Sometimes the problems for law enforcement agencies result not only from simple opacity and the lack of a paper trail relating to a person, but also the extra legal resource and weight that use of a company or legal person as a director can add in terms of blocking proceedings of an investigation. A particular source of difficulty is the use of corporate directors overseas; when other jurisdictions are involved, a series of bilateral requests and negotiations will take place to seek the relevant information, which can be slow or ineffectual, with the precise nature and value of the process depending on the jurisdiction in question.

86. Work with law enforcement agencies and wider consultation on the proposals robustly confirms that banning corporate directors from UK incorporated companies would benefit the process of investigating cases. As noted previously, there is no reliable or systematic way of attributing the prohibition of corporate directors to any reduction in law enforcement agencies' costs or the consequences for their processes of a reduction in them, and for this reason, the benefits resulting from reduced costs to law enforcement remain non-monetised[158].

87. We should also note that action to prevent the use of corporate directors forms only one part of the *Transparency and Trust* package. While it is difficult to reliably predict any significant change in the crime rate related to any one part of the package, we could consider that the overall combined

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153 *Crime in England and Wales, year ending June 2013 – Appendix tables'* (2013) Office for National Statistics (ONS)
154 Since the ONS data are only for offences committed in England and Wales and the NERA figures cited in Brand and Price (2000) split all UK recorded offences into those committed in each devolved administration, we applied the same proportional distribution as Brand and Price (91% of fraud offences committed in England and Wales; 8% committed in Scotland; and 1% committed in Northern Ireland) to arrive at an estimate of the total offences committed in the UK. This overall figure of 1 million excludes cheque and credit card fraud and accounts for the number of unreported offences, using the crime multiplier in NERA (2000).
155 To note unit costs are rounded for presentation in the text, with original figures used for calculation to give overall estimates.
156 Public sector costs include costs to the Criminal Justice System, the NHS, Customs & Excise & VAT, Inland Revenue and Local Authorities. The public:private sector cost distribution is calculated based on the distribution in the above table.
157 To note unit costs are rounded for presentation in the text, with original figures used for calculation to give overall estimates.
158 This is consistent with the approach taken in the recent Home Office analyses (Mills et all 2013) where the SOCA budget could not be attributed to categories of crime let alone, for our purposes, individual characteristics of categories of various crimes such as a particular use of corporate directors, and was considered separately as a unitary figure (£430m).

effect, including the deterrent of acting to implement the comprehensive package, is likely to be greater than the sum of its parts.

The scale of the economic benefits

88. Whilst law enforcement agencies were unable to quantify the deterrent effect that the *Transparency and Trust* package might have on fraud offences, we can offer some illustrative examples of the likely one-off economic benefits associated with reducing crime:
    - If the package resulted in a 2% reduction in crime, it would yield economic benefits of £10.5m (2% of £523m).
    - If the package resulted in a 5% reduction in crime, it would yield economic benefits of £26.1m (5% of £523m).
    - If the package resulted in a 10% reduction in crime, it would yield economic benefits of £52.3m (10% of £523m).

89. For further context, as mentioned, we can use the average cost estimate of ≈£1400, which includes transfers, to give an overall cost of fraud. On this basis, the total cost estimate rises to approximately £1.43 billion. Of this figure, around £1.16 billion falls on the public sector and £270 million falls on the private sector. The economic benefit of reducing corporate opacity to reduce this crime would similarly be derived from the reduction in these indicative costs.

90. Of course, feeding in to or stemming from illicit activity associated with companies are a range of organised crime and potentially terrorism offences, which would encompass offences beyond fraud. As noted in Brand and Price (2000), the crime multiplier associated with organised crime is substantial because it sustains and creates other criminal markets, which impose further costs on society. The recent Home Office analysis which accompanied the launch of the National Crime Agency (Mills et al 2013) highlights that organised crime cost the UK £24 billion in 2010/11, with drugs supply, for instance, costing the UK £10.9 billion within that total[159]. The Home Office analysis excludes money laundering, which as mentioned above has a significant impact across the globe.

91. The economic benefit of reducing corporate opacity could therefore reduce the costs arising from a wide range of criminal activity (and again the impact of the package could be greater than the sum of its parts).

92. The above analysis represents one means of monetising the overall economic cost of crime. At the same time, those costs of crime which cannot be monetised should also be considered. As Brand and Price (2000) set out, there are a range of potential emotional and physical impacts on victims of crime, which might leave a legacy of problems. Reducing crime based on corporate opacity, including through the use of corporate directors, will therefore realise benefits to national well-being, as measured by the National Well-being programme led by ONS[160].

93. Action will also help to develop an environment conducive to economic growth in the UK, and attendant benefits. There is a strong body of evidence highlighting how crime in itself acts as a drag on investment, job creation and ultimately economic growth. As set out in the ***rationale for***

159 Home Office analysis cost estimates presented do not include SOCA costs of preventing and responding to organised crime (Mills et al 2013, Understanding organised crime: estimating the scale and the social and economic costs, Home Office, Research Report 73) https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/246390/horr73.pdf .
160 http://www.ons.gov.uk/ons/guide-method/user-guidance/well-being/index.html This includes measures of the crime rate, happiness, anxiety and mental well-being.

intervention, Goulas and Zervoyianni [161] found that in times of macroeconomic uncertainty, an increase in crime rate is association with a reduction in annual GDP per capita.

94. As set out in the ***problem under consideration,*** there are also benefits to reducing crime which accrue not just in the UK but internationally. These are not within scope of this impact assessment but are nevertheless important. Illicit flows out of low income countries, particularly in Africa, will often be channelled through company structures. Though almost by definition figures are difficult to derive, the Africa Progress Panel chaired by Kofi Annan (2012) have highlighted the problem, citing research suggesting that between 1970 and 2008 $1.8 trillion were lost from the continent. Reducing the potential for abuse of the company structure should therefore derive benefits not only for crime in the UK, but for the UK's international reputation and for its international partners, particularly low income countries.

B2 Benefits to companies and individuals from corporate transparency supporting the business environment

95. Option one would deliver benefits for the business environment resulting from greater transparency around company control relating to a prohibition of the use of corporate directors.

96. Economic theory suggests that this increase in transparency is likely to reduce information asymmetry and increase trust, and therefore increase economic activity (see '***Rationale for Intervention'***). Empirical evidence in this area, whilst informative, relates to the general relationship, observed across the economy, rather than corporate directors specifically.

97. Enhancing corporate transparency will support greater trust in the business environment; ultimately, enhancing trust in the business environment serves to "grease the wheels" of economic activity and facilitate economic growth. Greater transparency is associated in the literature with greater investor confidence, alongside trust in companies and between companies. This enables economic transactions to go ahead more readily, since, for instance, a buyer will not be discouraged or delayed by a lack of transparency and trust in a seller, which enables them to safely simplify the contracting process between them[162]. Therefore increased corporate transparency can increase economic growth through the mechanism of increasing trust and reducing transaction costs.

98. A theoretical framework connecting transaction costs with trust was set out by Bromiley and Cummings (1995) who described a typical agency problem, between a shareholder (principal) who depends on the actions of the company board (agent). They explained, drawing on earlier findings, how a lack of trust can to feed into higher transaction costs[163]. This agency problem and the associated complexity related to trust can impact on transaction costs in other settings. Empirically this has received support from Dyer and Chu (2003)[164] who investigated the relationship between 344 buyers and suppliers in the automotive industry of the USA, Japan and Korea. Dyer and Cho concluded that transaction costs[165] were five times higher for the least trusted supplier.

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161 E*conomic growth and crime: does uncertainty matter* (2013). Goulas and Zervoyianni. Applied Economics Letters, Vol 20, issue 5, pp420-427

162 The importance of trust in economic transactions is highlighted in Fukuyama, F. (1996) 'Trust the social virtues and the creation of property'

163 *Transactions costs in organizations with trust* (1995) Bromiley, P. & Cummings, L.L. 'Research on Negotiations in Organizations, Vol. 5: 219–47, set up the theoretical framework, which connected transaction costs with trust. This was based on the findings of Williamson O.E. (1985) '*The Economic Institutions of Capitalism'* which formally founded the New Institutional school of economics. However, the literature is somewhat ambiguous as to the strength of the link between trust and transaction costs.

164 *The role of trustworthiness in reducing transaction costs and improving performance* (2003) Dyer J.H. and Chu W. 'Organisation Science, vol. 14 no 1, pp57-68

165 North, D.C. (1990) '*Institutions, institutional change and economic performance'*, defines transaction costs as 'the cost of measuring the valuable attributes of what is being exchanged and the costs of protecting rights and policing and enforcing agreements.' Transaction costs come in the form of searching for a contract and relevant information; bargaining and decision making relating to that contract; and policing and enforcing the contract.

99. There is also a known link between overall economic growth and trust,[166] with the literature commonly identifying a significant positive relationship between the two. This emerges because trust motivates investment, innovation and more broadly entrepreneurship[167]. To test the hypothesis that trust reduces transaction costs and therefore enhances growth at a national level, the empirical literature commonly analyses cross-country samples to assess how far countries with higher levels of trust have a higher rate of economic growth. Knack and Keefer (1996)[168] initiated this strand of the literature, finding that a 10 percentage point increase in trust, as measured by the World Values Survey (WVS), is associated with a 0.8 percentage point increase in growth. Zak and Knack (2001)[169] later extended this analysis by adding 12 countries to the dataset - again the relationship between trust and economic growth was significant and positive and a 10 percentage point increase in trust was associated with a 0.7 percentage point increase in growth.

100. The literature has built upon the two seminal papers by Knack and Keefer (1996) and Zak and Knack (2001) by testing their robustness and re-analysing the data. Beugelsdijk et al (2004)[170] find that the Zak and Knack (2001) study had highly robust trust coefficients in terms of significance and magnitude. However, they argued that the relative importance of trust in the study is somewhat affected by which countries are included in the sample and the factors that the regression controls for. More recently Horváth (2013),[171] however, found interpersonal trust to be a 'robust determinant of long-term economic development,' in a study of 50 countries. Indeed, Horváth disagreed with the findings of Beugelsdijk et al (2004) that the link between trust and growth is sensitive to the factors included in the model.

101. Analysis of U.S. states by Dincer and Uslaner (2010)[172] found a similar (though slightly weaker) relationship between trust and growth – a 10 percentage point increase in trust being associated with a 0.5 percentage point increase in the growth rate. This highlights that the relationship still exists in developed countries or jurisdictions where the rule of law is well established (where one might otherwise have expected it to be restricted to jurisdictions with weaker institutional infrastructure and greater reliance on knowing and trusting business partners).

102. The relationship between growth and trust is therefore a developing strand in the literature and there are some continuing points of debate around the data used. The empirical studies are often reliant on the World Values Survey, which asks the general question 'do you think people can be trusted?' Comparing responses over time, as Beugelsdijk (2006)[173] comments, might indicate more of a change in a population's honesty, attitudes or information rather than their behaviour. However, there are few alternative international measures for trust, which in itself is challenging to measure.

103. The literature does not generally analyse the mechanisms through which trust affects growth. As noted by Dincer and Uslaner (2010), one might expect trust to affect growth via the main growth drivers. To elaborate, one can envisage individuals in less developed countries with low levels of

166 The literature commonly considers trust in a general sense rather than specifically looking at trust in the business environment. A frequently used source is the World Values Survey (WVS). This is a cross-country social survey of beliefs and values, which asks 'do you think people can generally be trusted'. Although the WVS is not directly related to the level of trust in the business environment, as noted by Beugelsdijk (2006) it is strongly correlated with the effectiveness of institutions, which includes industry/business as an institution. We can therefore expect trust to be a good proxy more specifically for trust in the business environment .

167 However, the literature must carefully control for reverse causality, i.e. how far high growth countries are generally more trusting.

168 *Does social capital have an economic payoff?: A cross-country investigation* (1996) Knack, Stephen and Philip Keefer, The Quarterly Journal of Economics, 112(4), pp. 1251

169 *'Trust and growth'* (2001) Zak, P.J. and Knack, S Economic Journal, 111, 295–321.

170 *Trust and Economic Growth: A robustness analysis, (2002)* Beugelsdijk, S. de Groot, H.L.F. & van Schaik, A, (2002) " Oxford Economic Papers 56 (2004), 118–134

171 *Does trust promote growth?* (2013) Horváth, R., 2013. Journal of Comparative Economics, Elsevier, vol. 41(3), pages 777-788.

172 *'Trust and Growth' Public Choice* (2010) Dincer and Uslaner 142: 59–67

173 *A note on the theory and measurement of trust in explaining differences in economic growth* (2006) Beugelsdijk, S. Cambridge Journal of Economics, 30, 371–387

trust might be more hesitant in engaging in entrepreneurial activity, for fear of protecting their contractual rights, and a lack of innovation and/or investment will certainly impede growth.

104. Two notable exceptions are Bjørnskov (2012)[174] and Botazzi et al (2010)[175], which both examine mechanisms through which trust influences growth. Using cross-country data, Bjørnskov (2012) shows that a lack of trust limits the level of schooling, which in turn limits the investment rate and ultimately economic growth. Botazzi et al (2010) identify the strength of the relationship between trust and investment decisions in European venture capital markets. The theoretical mechanism identified by Botazzi is also similar to that found by Guiso et al (2008)[176], who look at stock market participation. Essentially, trust has an impact on an investor's perception of brokers and intermediaries, and a lack of trust thereby raises transaction costs and reduces the investment rate.

105. In and of itself, trust is not likely to drive growth, but it certainly feeds into stability and certain economic systems which are key to economic activity. In terms of its relative importance as a factor underpinning growth, Whiteley (2000)[177] found evidence suggesting that social capital, defined as the extent to which people are prepared to co-operate based on interpersonal trust, has a significant impact on growth, at least as strong as education or human capital.

106. By increasing corporate transparency, including through prohibiting the use of corporate directors, benefits to trust, and therefore the business environment and potentially economic growth, should be realised.

Costs

107. Corporate directors can be used in companies undertaking legitimate business (for instance in group structures, or when a parent company is engaging with a subsidiary). Prohibiting corporate directors entirely would introduce a one-off cost for these companies in order to comply with the policy change (as well as affecting company structures involving corporate directors to create opacity to support criminal purposes).

108. The costs that companies would need to incur to comply with the policy change would fall into the following main categories:

a) Public Sector Communication and Implementation Costs

C1. Public sector communication and implementation costs

b) Private Sector Costs

C2. The replacement of a prohibited corporate director, should the company decide to pursue that course (staff time and any additional costs)

C3. Any resulting disruption, reputational damage and loss of benefits after corporate directors are prohibited and removed

C4. Familiarisation with the policy change (staff time and any additional costs)

109. In terms of forgone efficiency, cost (C3) is also ongoing to future companies, which would have benefitted from the use of a corporate director.

110. The cost estimates below are based on a range of evidence drawing in large part on a survey of companies undertaken by IFF Research (see Annex A). The costs identified through the survey have been processed before being applied to wider populations of companies to arrive at estimates of the overall impact of the policy. This processing has included the removal of values that could

174 Bjørnskov (2012) 'How Does Social Trust Affect Economic Growth?' Southern Economic Journal, Working Paper 06-2
175 Botazzi, L., Da Rin, M. and Hellman, T. (2010) 'The importance of trust for investment' NBER Working Papers 16923
176 Guiso, L, Sapienza, P. and Zingales, L. (2008) 'Trusting the Stock Market' The Journal of Finance, Vol 63, Issue 6, pp2557-2600
177 Whiteley, P. (2000). "Economic Growth and Social Capital," Political Studies 48, 443-466.

make the dataset less robust, including implausible 'zero' values and very high values (again, see Annex A).

111. For the basis of these calculations it should be noted that the current register held by Companies House reveals there are around 67,000 companies with corporate directors in the UK (29,000 are LLPs with corporate members[178]), 100,200 separate corporate directorships and around 76,000 individual companies who act as corporate directors. Some companies have more than one corporate director, and some companies act as a corporate director for more than one company.

a) Public Sector Communication and Implementation Costs

C1) Public Sector Communication and Implementation Costs

112. To ensure all companies are fully aware of the regulatory changes associated with reducing the use of corporate directors and indeed the rest of the *Transparency and Trust* package, Companies House will engage in a large scale communications campaign.

113. The last campaign of a similar size was when Companies House publicised the new Companies Act 2006 and its introduction in 2009; this cost Companies House £800,000. The 2009 changes were broader in scope than the current package, including accounts and audit for instance, though they related to a smaller number of companies than are on the register at present[179]. However, these costs were largely derived from a direct mailing, and costs could be reduced if this were not the centre of the campaign.

114. To communicate the *Transparency and Trust* reforms, it is likely that Companies House would use a mix and balance of cost effective and targeted communications to companies. Companies House has indicated that the anticipated costs of sending a mail insert (alongside other communications) covering *Transparency and Trust* reforms to 3.19m[180] companies is around £23,000. This could be supplemented by website notices and guidance; FAQs; and social media information. Direct engagement with company agents and representatives through Focus Groups and events would also be helpful. As the policy is further developed we will be able to develop handling plans and therefore further refine the cost estimates.

115. Moreover, communication of each part of the package and of the changes derived from the Company Filing Requirements consultation could be delivered, as appropriate, in concert, and the costs of communicating each individual measure thereby reduced. So, for instance, if we were to divide the communication costs between two sets of measures,[181] the costs for communicating each policy measure would be around £11,500.

116. In terms of development and implementation costs, Companies House will need to validate which companies are prohibited from having corporate directors and change the annual return containing information on corporate directors. In discussions with Companies House, this was estimated to cost around £40,000.Though these costs account for development, they do not include any other business costs such as training or communication, and if there is a need for external resource this could cost more. Exact costs will depend on precise details to be determined, and the structure in particular of transition arrangements.

178 Of which around 29,000 are LLPs
179 Based on the Companies House Annual Report of 2012/13:
http://www.companieshouse.gov.uk/about/pdf/companiesRegActivities2012_2013.pdf
180 Company population estimates were extracted from the FAME database (Bureau van Dijk Electronic Publishing, 2013) on 13 December 2013

117. Our best estimate of costs for Companies House will total **£51,500**.

118. This Impact Assessment assumes 100% compliance in accordance with standard practice, thus court costs would theoretically be zero. However, we have considered the impact on the criminal justice system. Depending on the deterrent effects, wider changes to enforcement strategies and other limiting factors affecting prosecutions, it is not simple to define how the enforcement of the policy would affect the criminal justice system, but there is scope for an effect. A full Justice Impact Test is being developed with the Ministry of Justice.

b) Private Sector Costs

C2) The replacement of a prohibited corporate director (staff time)

119. To identify how a company would behave and what costs might arise following a prohibition of corporate directors, the survey posed hypothetical questions of all companies questioned. Companies House data indicate there are only 67,000 companies with corporate directors so the probability of surveying any one of them was around 2%. However, in the survey, 10% of companies sampled did indeed have a corporate director on their board.

120. To identify where costs would fall, the survey first sought to understand whether or not companies would commonly replace a corporate director following their prohibition. Companies were then asked what the costs in terms of staff time and any additional costs might be required to remove and replace their corporate director.

121. The survey found that 50% of companies would replace a prohibited corporate director with a 'natural person'[182]. Of the companies that indeed did have a corporate director, 42% would replace them[183]. However, this is based on a relatively small sample of 55 companies so there is a risk that this sample is not representative of the population. Therefore, we use the 50% figure (based on the full sample), which is likely to produce overestimates of the cost.

122. Moreover, given the lack of evidence relating to the remaining 50% of companies which are predicted only to remove their corporate director (rather than remove and replace), we conservatively assume here that this (quicker and cheaper) process costs the same.

123. Our company survey identified a 'high' estimate of around £166 for a company removing and replacing a corporate director. We apply this cost to the total number of corporate directorships rather than to the number of companies with corporate directors because we consider the process behind each removal/replacement in isolation. Analysing the costs per company would underestimate the total cost.

124. This gives a total, our 'high' cost estimate, of around £17m for this group of companies, which is therefore likely to be an overestimate. This is calculated as follows:

(≈£166 x (50% x 100,200)) + (≈£166 x (50% x 100,200)) = £17m
(Cost of replacement x (replacement percentage x companies with corporate directors) + (Cost of removal x ((1 - replacement percentage) x companies with corporate directors)

182 This percentage includes the responses of companies which said 'don't know' to the question 'would you remove and replace your corporate director'. We have distributed the 'don't' know' responses across the 'yes' and 'no' responses in proportion to the responses excluding the 'don't know' responses.
183 The three companies which responded 'don't know' have been distributed across 'yes' and 'no' as per the above.

125. There is also scope for overestimation if we envisage the costs of removal and replacement to be due to economies of scale. On average, companies with corporate directors have around 1.5 corporate directors, so one might expect lower costs for the companies with more than one corporate director.

126. Our ‘high’ cost estimate of £17m assumes no efficiency savings. For our ‘low’ estimate we have assumed it takes around half (50%) of the cost to process the removal or replacement of another director, giving total costs of £7m. This is based on a ‘low’ estimate that it costs around £103[184] to comply with the appropriate process.

127. Under an assumption that it takes around three quarters (75%) of the time to process another removal or replacement, our ‘best’ estimate is **£11m**, which uses an estimated cost of ≈£132. We have applied this cost saving only to 56,000 corporate directors which are present on a company board with at least one additional corporate director. The remaining 44,200 corporate directors, which are on company boards without another corporate director, do not benefit from any cost savings. Our ‘best’ estimate is calculated as follows:

(56,000 x (≈£132 x 75%)) + (44,200 x ≈£132) = £11m
(Number of corporate directors on a board with more than one corporate director x (cost of replacement x cost saving)) + (Number of companies on a board without another corporate director x cost of replacement)

128. Although we do not have data with which to estimate the cost savings more precisely, these set out our understanding of the potential scenarios for changing every current corporate directorship in the UK, and leave scope for even greater reduction in costs relative to these estimates.

Estimate	Cost savings	Removal/replacements benefiting from cost saving	Average cost per company	Total cost
High	0%	56,000	£166[185]	£17m
Best	75%	56,000	£132	£11m
Low	50%	56,000	£103	£7m

Table 2: Removal and replacement cost estimates for companies with a corporate director

129. When each corporate directorship is replaced, there would also be costs for the company *acting* as a corporate director. These costs were similarly assessed through the survey. Again assuming the same costs for removal apply to combined removal and replacement, it is estimated that costs of on average ≈£139[186] (as a ‘best’ estimate) would fall on companies acting as corporate directors. Overall, this equates to **£14m** as a ‘best’ estimate. The formula below details how we arrived at our estimates and the table details the ‘high’, ‘low’ and ‘best’ estimates.

≈£139 x 100,200 = £14m
Cost of removal/replacement x number of corporate directorships

184 This is based on the survey’s cost estimates using a mean truncated at the 96th percentile. The ‘high’ estimate uses a mean truncated at the 98th percentile, whilst the ‘best’ estimate uses a mean truncated at the 97th percentile. Full methodological details are available in Annex A.
185 Unit costs are rounded for presentation in the text, original values used for calculation of overall effects.
186 This is based on the survey’s cost estimates using a mean truncated at the 97th percentile. The ‘high’ estimate uses a mean truncated at the 98th percentile, whilst the ‘low’ estimate uses a mean truncated at the 96th percentile. Full methodological details are available in Annex A.

Estimate	Number of corporate directorships	Average cost per company	Total cost
High	100,200	£257[187]	£26m
Best	100,200	£139	£14m
Low	100,200	£105	£11m

Table 3: Removal and replacement cost estimates for companies acting as a corporate director

130. We do not apply any efficiency savings to these estimates due to a lack of data outlining how many company boards each corporate director is present on. These figures therefore potentially overestimate the cost.

131. Using our 'best estimates'; as set out above, the overall one-off costs, including costs for companies with corporate directors and costs for companies which are corporate directors, total around **£25m**.

C3) Any resulting disruption, reputational damage and loss of benefits after corporate directors are prohibited

132. Corporate directors can be used by companies operating entirely legitimately, for instance in group structures. A blanket prohibition would therefore cause these users to lose any associated benefits from having a corporate director and could potentially cause them to suffer reputational damage or disruption.

133. As set out below, the survey yielded a mixed response regarding advantages of having a corporate director. Given how few companies currently choose to use a corporate director, it is not surprising that 74% of companies surveyed saw no advantage to having one.

134. However, of the responses from the 10% of companies which did have corporate directors on their board, interestingly, 31% saw no advantage to having one present. Below we interrogate these data from companies with corporate directors. Although this is a small sample and far from representative of the population, the responses from companies *with* corporate directors are expected to be more accurate a reflection of views than those of companies *without* corporate directors who have responded to hypothetical questions as part of the full sample.

135. The most common advantages cited amongst those with corporate directors was that a corporate director on a company's board could broaden the skills and knowledge of the board (24%) and that they bring continuity to the management of the company (9%). Approximately 5% of respondents thought corporate directors were advantageous on efficiency grounds.

136. Applying this to the 67,000 companies with corporate directors, we can therefore estimate that 16,000 companies would suffer costs resulting from a loss of skills and knowledge; 6,100 companies would lose management continuity; and 3,400 would suffer a loss of efficiency. This would total at most 26,000 companies or less than 1% of all UK companies.

137. Under option 1, with corporate directors prohibited entirely, the loss of these advantages could result in costs for companies with corporate directors (and companies which might later have

187 Unit costs are rounded for presentation in the text, original values used for calculation of overall effects.

chosen to appoint one). For the purposes of this consultation stage Impact Assessment, the potential impact is non-monetised but we will continue to seek to monetise this impact for the final stage impact assessment. Nonetheless, in terms of scale, these companies represent only a small proportion of the companies which have corporate directors at present.

Response to question regarding advantages of corporate directors	**% of companies (drawn from those with a corporate director)**
None / No advantages	31%
Broadens skills / knowledge	24%
Other	13%
Continuity	9%
Improve efficiency / save time / money	5%
Anonymity	4%
Flexibility	2%
Access to a wider network of people	2%
Access to finance	2%
Good for company's image	2%
Makes decision-making easier	2%
Don't know	11%

Table 4: Answers by companies with corporate directors to the survey question: 'what advantages can you see to having a corporate director on the company's board?'

138. We also explored the potential for any direct impact resulting in costs to business from a prohibition of corporate directors, for instance in terms of reputational damage or disruption. 71% of companies with corporate directors on their boards thought there would be no additional costs; 4% of companies thought the prohibition of corporate directors would damage their reputation; and 5% thought it would cause some disruption to their business. Applying this to the 67,000 companies with corporate directors, we can therefore estimate that 2,700 companies would suffer costs resulting from reputational damage and 3,400 companies would suffer business disruption. This would total at most 6,100 companies or 0.19% of all UK companies.

139. In surveying companies from the point of view of those acting as corporate directors, 86% of companies acting as corporate directors envisaged no additional costs. However, 2% of companies envisaged a negative impact on reputation and none thought there would be any disruption to their business. In terms of the 76,000 individual companies acting as corporate directors, this could equate to 1,500 companies.

C4) Familiarisation with the proposals (staff time and any additional costs)

140. The below calculations use the results of the survey to estimate the one-off familiarisation cost associated with the prohibition of corporate directors entirely (option 1). We have also conducted some sensitivity analysis around our estimates.

141. The survey identified an average familiarisation staff cost per company of ≈£130. The sample results were noteworthy; 32% of companies anticipated no familiarisation costs, while a number of companies reported costs significantly higher than previous estimates of familiarisation costs for similar policy changes.

142. We have calculated a ‘high’ cost estimate, where we assume that all 3.19 million (active and dormant) companies registered in the UK[188] will be required to read, review and understand the regulatory changes (whether they do or do not currently have a corporate director). Overall, this gives total familiarisation costs of £411m.

≈£129 x 3.19m[189] = £411m[190]
Cost of familiarisation x number of companies

143. However, we consider this to be a significant overestimate of the familiarisation costs, because the core of those needing to familiarise themselves with a policy change would be those companies which have corporate directors. If indeed a company without a corporate director were to review the policy change, it would be identified as irrelevant to their company almost immediately. In line with previous and standard practice for such changes, we base our estimates of familiarisation costs on our understanding of the companies within scope.

144. Our ‘low’ estimate totals £5m and is based on all 67,000 companies with corporate directors familiarising themselves with the changes at a cost of ≈£74[191] each (≈£70 x 67,000). More realistically, our ‘best’ estimate assumes that both companies with corporate directors and the companies which are (that is to say, act as) corporate directors will familiarise themselves with the regulatory changes. This totals **£14m** (≈£96 x 143,000).

Estimate	Number of companies	Average cost per company	Total cost
High	3.19m	£129[192]	£411m
Best	143,000	£96	£14m
Low	67,000	£74	£5m

Table 5: Familiarisation cost estimates

Option 2 (preferred option) – Prohibiting the use of corporate directors save in defined circumstances

145. As set out above, this option consists of a prohibition of corporate directors with the potential for exemptions. These exemptions would be at the discretion of Ministers and could usefully apply where we consider there is reduced potential for abuse (for instance where the companies involved are large and subject to stringent transparency requirements elsewhere), and where we consider the reasons for use of a corporate director might, *a priori*, be considered more likely to be legitimate (for example in terms of supporting co-ordination in group structures). When these exemptions are formalised in regulations, we will bring forward a separate and specific Impact Assessment to explain that step. For the present purposes, we set out the relative costs and benefits of some illustrative scenarios, setting out potential exemptions. We suggest there might be reasons to pursue exemptions for companies in some or all of the below groups:
   - Listed companies on an EU regulated market in large group structures
   - Large private companies in group structures
   - Charity companies

188 Company population estimates were extracted from the FAME database (Bureau van Dijk Electronic Publishing, 2013) on 13 December 2013
189 Company population estimates were extracted from the FAME database (Bureau van Dijk Electronic Publishing, 2013) on 13 December 2013
190 Unit costs are rounded for presentation in the text, original values used for calculation of overall effects.
191 This is based on the survey’s cost estimates using a mean truncated at the 97th percentile. The ‘high’ estimate uses a mean truncated at the 99th percentile, whilst the ‘best’ estimate uses a mean truncated at the 98th percentile. Full methodological details are available in Annex A.
192 Unit costs are rounded for presentation in the text, original values used for calculation of overall effects.

- Pension companies

146. The below table details the number of active UK companies under each of the proposed exemptions using estimates from the Fame database[193]. Based on these figures, and using the average share of companies with corporate directors (2.1%) and the average share of companies which are (that is to say, act as) corporate directors (2.4%), we can estimate the number of companies that would be in scope of the proposed exemptions. For the purposes of this Impact Assessment, we will work under the assumption that all four exemptions set out in the present example are legislated for. However, the estimated costs and benefits can easily be disaggregated to offer useable estimates for any combination of these exemptions, and the same approach could be applied to any further desired exemptions.

	Total number of companies	Estimated number of companies with corporate directors (2.1% of total)	Estimated number of companies acting as corporate directors (2.4% of total)
Listed & group structure[194]	1,200 with 61,500 subsidiaries	30 / 1,300 including subsidiaries[195]	30/1500 including subsidiaries
Charity[196]	22,100	400	500
Pension funding[197]	1,400	30	30
Private & group structure[198]	15,400 with 48,800 subsidiaries	300 / 1,400 including subsidiaries	400 / 1,500 including subsidiaries
Total	38100 / 148,000	800/3,100	910 / 3500

Table 6: Estimated number of exemptions (rounded to nearest 100 companies)

Benefits

147. The benefits of option two (prohibiting corporate directors with specific exemptions), should be broadly the same as those that would be delivered under option 1 (prohibiting corporate directors entirely).

148. The total of all four exemptions as described above would allow up to 148,000 companies to use a corporate director. Our estimates, using current uptake (around 2.1 % of companies have corporate directors) and applying it to that population, would indicate that less than 3,100 would do so. Ultimately, therefore, this would lead to a large reduction in the use of corporate directors and only a small rise in the usage of corporate directors relative to that seen in option one. As noted above exemptions will be restricted to sectors which we can change if necessary, but where overall we are confident in wider regulatory and disclosure requirement.

149. Not only would the direct benefits with respect to reducing crime be accrued under option two without much reduction relative to option one, we could also consider that the benefits arising from the deterrent effect and the signal sent by the policy change would stand, given the default position

193 FAME database (2013) Bureau Van Dijk Electronic Publishing. Retrieved on 24 October 2013
194 This includes companies listed on an EU regulated market and filling group accounts.
195 Companies House data indicate that there are 100 listed companies with corporate directors. As such our estimate of 30 is conservative. We apply 30 here for consistency with the methodology used to calculate the number of companies in scope of the other exemptions.
196 Charities are categorised under SIC (2007) codes 87.200, 87.300, 87.900, 88.100, 88.910 and 88.990 (based on www.doeni.gov.uk/niea/sic_2007.pdf). However, this is likely to be an overestimate because some of the SIC codes do include non-charitable companies so we cannot fully distinguish between the two. Nonetheless, charity shops, which are listed under the relevant retail activity cannot be directly included in this count, which may balance the scale of this underestimate to some extent.
197 This includes companies classified under SIC (2007) code 65.300
198 This is based on companies identified as private and filling group accounts.

of a prohibition. Similarly, in terms of the benefits arising as a result of improvements to the business environment, we could consider that they will also largely stand as they do for option one, since the policy change including the default prohibition will send a strong signal in terms of trust in business in the UK.

150. Since option two retains the best features of a prohibition but requires change of fewer companies, and where those companies are carefully determined in relation to their other regulatory requirements and the likelihood of legitimate use of corporate directors, the same benefits can be delivered at reduced cost to business.

Costs

151. In terms of the overall impact, a system of specific exemptions will reduce the costs falling on the types of companies which are already highly regulated and indeed more likely to benefit from the usage of corporate directors.

a) Public Sector Communication and Implementation Costs

C1) Public Sector Communication and Implementation Costs

152. As for option one above, there would be some costs occurring to government, largely to BIS and / or Companies House, in order to communicate the changes to the companies involved, and to then implement the system changes required. Using the same approach as for option 1, these costs would total £51,500, which consists of £40,000 for system changes and around £11,500 for communications.

b) Private Sector Costs

C2) The replacement of a prohibited corporate director (staff time and any additional costs)

153. In terms of costs of actually complying with the policy change, we estimate that there would be around 4,000 fewer corporate directors removed and replaced under this option relative to option 1 (the total in column 3 of table 6). This will slightly reduce the associated costs to **£11m** for our 'best' estimate. The corresponding 'low' and 'best' estimates are calculated below, adhering to the same cost saving method as in option 1.

100,200 - 3,100 = 97,000
Number of companies with corporate directors - exemptions = Number of companies with corporate directorships in scope

97,000 x 56% = 54,200
Number of companies with corporate directors in scope x share of companies with more than one corporate director = Number of removal/replacements benefiting from the cost saving

100,200 - 3,500 = 96,600
Number of companies acting as corporate directors - exemptions = Number of corporate directors in scope

Estimate	Cost savings	Removal/replacements benefiting from cost saving	Average cost per company	Total cost
High	0%	54,000	£166[199]	£16m
Best	75%	54,000	£132	£11m
Low	50%	54,000	£103	£7m

Table 7: Removal and replacement cost estimates for companies with a corporate director

154. As for the costs for companies acting as corporate directors, a reduction in the number of prohibited companies acting as corporate directors of around 4,200 (the total in column 4 of table 6) will reduce costs relative to option 1 by just under £1m. This will total **£13m** as a 'best' estimate.

Estimate	Number of corporate directorships	Average cost per company	Total cost
High	96,000	£257[200]	£25m
Best	96,000	£139	£13m
Low	96,000	£105	£10m

Table 8: Removal and replacement cost estimates for companies acting as a corporate director

155. Overall costs for this section, including costs for companies with corporate directors and costs for companies which are corporate directors, will therefore total **£24m**.

C3) Any resulting disruption reputational damage and loss of benefits after corporate directors are prohibited

156. As per option one, any ongoing costs related to the loss of advantages conferred by use of a corporate director remain non-monetised. However, the number of companies directly experiencing any loss of an advantage, based on the percentage estimates in option 1, might be reduced relative to option one. Evidence from the consultation on these measures highlighted the particular value of corporate directors in certain parts of the company landscape, and to the extent that we match the exemptions not only to low risk areas but to these high value areas, we anticipate a non-linear reduction in impact of loss of advantage relative to option 1.

157. The estimated total number of companies losing skills and knowledge under option 2 would be 15,400 (24% of the 64,200 companies not exempt from the prohibition), an estimated 5,800 (9% of 64,200) would suffer a loss of business continuity and 3,200 (5% of 64,200) may suffer a loss of efficiency.

158. Similarly, the ongoing direct costs, although non-monetised, would fall on fewer companies. We anticipate that the number of companies with corporate directors which would suffer reputational damage as a result of prohibition would fall to 2,600 (4% of the 64,200 companies not exempt from the prohibition), and the number of companies suffering disruption to their company would fall to

199 Unit costs are rounded for presentation in the text, original values used for calculation of overall effects.
200 Unit costs are rounded for presentation in the text, original values used for calculation of overall effects.

3,200 (5% of 64,200). From the perspective of costs for the 76,000 companies acting as corporate directors, which is expected to fall to 72,500 including the exemptions, around 1,500 companies (2%) are estimated to suffer a negative impact on their reputation.

C4) Familiarisation with the proposals (staff time and any additional costs);

159. As set out in option one, many companies would immediately realise that a policy change in relation to corporate directors would not apply to them, since they neither had one, nor acted as one. Given a simple and well communicated set of exemptions, and the high likelihood of a company being aware of its own status and /or function, companies could similarly recognise rapidly whether or not they were in scope of the exemptions. Therefore, fewer companies would need to go through all the stages of familiarising themselves with the changes they need to make.

160. As set out above, around 150,000 companies in this illustrative scenario could be in scope of an exemption and able to use a corporate director in the new framework. If they realised this rapidly and therefore if 150,000 fewer companies, relative to option one, went through the full familiarisation process as detailed in table 6, this would reduce costs accordingly. Below, however, we undertake some sensitivity analysis on this point.

161. For our high estimate we assume that all the exempt companies will require some familiarisation to grasp that they are indeed exempt. As a result, our 'high' estimate is the same as under option 1.

162. As explained, however, we can apply familiarisation costs to those companies likely to be directly within scope of the proposed policy change. This remains a conservative assumption since current take-up of the use of corporate directors is a low percentage of those who are currently eligible (2.1% of companies) and so the number of companies within scope of the exemptions, using a corporate director and therefore needing to go through full familiarisation is likely to be well under 150,000. 3.19m companies minus 150,000 exemptions would give a total cost of £392m[201].

163. For our 'best' and 'low' estimates, given in the table below as **£13m** and £5m respectively, we have assumed a uniform distribution of corporate directors across all 3.19m companies[202], whether they are listed, charity companies, pension companies, private groups or otherwise[203]. This enabled us to remove the appropriate number of exempt companies, weighted accordingly to the population of interest. We applied the below formula, displayed for our 'best' estimate, using the figures in the table:

(143,000 – ((150,000 / 3.19m) x 143,000) x ≈£96 = £13m
Original number of companies - ((150,000 / 3.19m) x original number of companies) x Familiarisation costs

Estimate	Original number of companies	Number of companies including exemptions	Average cost per company	Total cost
High	3.19m	NA	£129[204]	£411m
Best	143,000	135,000	£96	£13m
Low	67,000	64,000	£74	£5m

Table 9: Familiarisation cost estimates

201 NB this figure is not included in the table as a high, best or low estimate.
202 Company population estimates were extracted from the FAME database (Bureau van Dijk Electronic Publishing, 2013) on 13 December 2013
203 The register as held by Companies House does not disaggregate corporate director data by SIC to allow us to apply specific figures.
204 Unit costs are rounded for presentation in the text, original values used for calculation of overall effects.

Rationale and evidence that justify the level of analysis used in the IA (proportionality approach)

164. We believe that the analytical approach taken in this Impact Assessment is proportionate. The table below sets out the data we would have required to have obtained a full monetised analysis and why we were not able to include this.

165. The *Transparency and Trust* package was started with initially very limited evidence, primarily because the criminal nature of the problem we are targeting makes data collection challenging. Moreover, the breadth of the areas addressed in the package have not been studied in detail before.

166. During the consultation, which fed into the evidence base underlying this Impact Assessment, we have:

- consulted with the Economic and Social Research Council;
- consulted with Companies House
- undertaken a full literature review;
- opened an online survey accessible by the general public;
- consulted with business, regulated entities and Law enforcement agencies in a series of focus groups and one-to-ones meetings; and
- commissioned a company survey through IFF Research (see Annex A).

167. Following consultation, we have continued to closely engage key stakeholders. The evidence gathered from stakeholders has and will continue to play a key role in our ability to determine which policy options will have the desired effect, without unintended consequences or imposing unnecessary burdens on business.

168. In terms of examining the benefits of corporate transparency for the business environment and those operating within it, Companies House and FAME data first enabled us firstly to identify the population of companies in scope. Once we had conducted a detailed literature review, which made good use of the expert knowledge within the Economic and Social Research Council, we were then able to identify the associated benefits of the *Transparency and Trust* package, including evidence of the important relationship between trust and economic growth. In general, however, the relevant economic literature is in its infancy, which made it unfeasible to monetise the benefits of corporate transparency for the business environment.

169. The benefits arising from the potential reduction in crime could not be fully monetised, as noted above, because of the limitations to law enforcement agency data. Given the huge scale of any corporate investigation and the corresponding myriad evidence, there is no systematic distillation of crime data such that we can interrogate the impact of a single factor, such as corporate opacity or specifically the use of corporate directors. We have offered an indication of the scale of the potential benefits but without estimates of the deterrent effect on crime resulting from *Transparency and Trust* measures, we could go no further to monetise them.

170. The evidence we have gathered to inform cost estimates in this Impact Assessment is drawn in large part from a company survey we commissioned through IFF Research. The study was the first of its kind, analysing in detail the costs associated with enhancing corporate transparency. Despite the lengths we went to in order to gather evidence there was still a need for processing of the data to obtain estimates for use in this Impact Assessments, and timing and proportionality constraints with respect to further interrogation of the responses provided to the survey (see Annex A).

171. We are satisfied that the evidence presented here represents the most comprehensive and robust assessment available for a consultation stage Impact Assessment within the constraints of proportionality with respect to both cost and time. As we develop the evidence base to progress from to a final stage Impact Assessment we will continue to develop all the sources of evidence available, subject to proportionality constraints.

Cost/ Benefit	Evidence/ Data gap	Why this evidence has not been included in the IA
Benefits		
Benefits from reduction in crime	(i) Reduction in crime rate (ii) Unit cost of money laundering	• Lack of evidence in the academic literature. • During the consultation, none of the respondents were able to provide quantified evidence in this area. This was often due to data not being recorded in such a form which is easily accessible or usable for economic appraisal purposes. • Paucity of evidence on money laundering is common for all financial crime. As noted by the FATF: 'it is absolutely impossible to produce a reliable estimate of the amount of money laundered'[205] • Evidence from the Home Office does not fully disaggregate by type of fraud and only gives a high level aggregate figure.
Reduced costs for law enforcement	(i) Monetised cost impact	• During the consultation, none of the law enforcement agency respondents were able to provide quantified evidence on the total reduction in crime or indeed the cost impact. This was often due to data not being recorded in such a form which is easily accessible or usable for economic appraisal purposes.
Corporate transparency and accountability	(i) Measureable growth impact	• Lack of evidence in the literature. There is a clear link between growth and trust but the literature is not yet developed enough to attribute changes in corporate governance to trust and ultimately growth.
Costs		
Familiarisation with the proposals	N/A	N/A
Replacement of a prohibited director	(i) Separate costs estimates for removal and replacement of directors	• Limitations to scale and scope of company survey with IFF Research.
Disruption/reputational damage	(i) Monetised disruption and damage to corporate reputation	• Given that reputation and disruption are intangible for companies and the impact of the proposals are not easily foreseeable for the companies answering the company survey, this question was not asked.
Communication, publication and implementation costs for govt.	N/A	N/A

205 Financial Action Task Force: "Money Laundering FAQ;" FATF website

Risks and assumptions

172. Following standard Impact Assessment methodology, we have assumed 100% compliance. There is, however, a risk of non-compliance and an impact on the criminal justice system. This is the subject of a Justice Impact Test under development with the Ministry of Justice.

173. Related to the previous point, there is a risk that benefits from a reduction in criminal activity will not be profound, or that individuals willing to undertake criminal activity might find other ways to hide their interest or involvement in a company. This is not anticipated in this Impact Assessment, but it might have an impact on the level of benefits achieved by the proposals. This risk is likely to be mitigated by robust action being taken across the *Transparency and Trust* package, as envisaged by the suite of proposals.

174. Moreover, crime estimates were only available for England and Wales so we scaled them up to cover the whole of the UK. This enabled us to calculate the volume of crime committed and the associated costs across the whole UK.

175. In addition, the impact of the *Transparency and Trust* package on the crime rate has not been possible to measure. Given the lack of evidence available from law enforcement agencies relating to money laundering, we have only been able to estimate the total economic cost of fraud to give some indication of the scale of potential benefits.

176. The evidence suggests that the Transparency and Trust package will as a whole have benefits with respect to growth because of its impact on trust. However, our ability to disaggregate to the level of individual component parts of the package, specifically the use of corporate directors, is limited. We assume the growth impact will be non-negligible when combined with the rest of the package. We have also made assumptions in adopting the approach of (2006) to the relationship between trust and growth. The mechanism through which increasing transparency is considered to affect growth is the enhancement of trust in the business environment. However, the majority of the academic literature related to trust and growth looks generally at societal level trust. Beugelsdijk (2006) considers 'trust' a good proxy for trust in the business environment because trust according to the World Values Survey (WVS) measure is highly correlated with the effectiveness of institutions.

177. In relation to the cost of crime estimates we have used, there are a series of underlying assumptions:
- Our costs estimates are largely based on figures derived from an externally contracted survey of 600 companies, undertaken by IFF research (see Annex A).
- The weighted and adjusted mean from the IFF research as been applied to all 3.19m dormant and active UK companies[206].
- Data relating to financial crime is highly limited and not sufficiently disaggregated to interrogate eg money laundering in isolation. We have relied on Home Office estimates from 2000, removed benefit fraud figures, scaled them up to 2013 prices and assumed no change in the number of offences committed. Given that one might expect fraud in general to impose lower costs on society than large scale money laundering offences, our estimates are therefore conservative.

178. There is a risk that we have not accurately accounted for a potential impact on overseas investment in the UK and UK competitiveness arising from the package and its perception, particularly since the UK is a 'first-mover.'

206 Company population estimates were extracted from the FAME database (Bureau van Dijk Electronic Publishing, 2013) on 13 December 2013

179. The OECD have noted as a general principle that *"excessive compliance costs, shortening the disclosure period and information overload problems, discourage (foreign) investments in listed companies and negatively affect shareholder engagement.*[207] They also note that *"costs of a disproportionate and stringent disclosure regime makes it more difficult for emerging growth companies to attract public investors, these companies will be induced to rethink their stock market aspirations, thereby hampering economic growth and job creation.*"[208] These issues might well be relevant for non-listed companies also.

180. Overall, the risk of accounting for this effect with respect to the *Transparency and Trust* package must be contextualised with respect to the significant influence of many other factors on the UK's ability to attract investment. The UK is the 10th most competitive economy in the world; the WEF highlights the UK strengths in technology, labour market efficiency, infrastructure, business sophistication and market size, which will by no means be eroded by greater corporate transparency.

181. The main drivers of Foreign Direct Investment (FDI) would not be likely to be adversely affected by the *Transparency and Trust* package, and indeed could be positively affected. Generally, strong economic fundamentals are thought to be the most important determinants, as highlighted by the OECD. In most cases, these include comparative advantage, political and macroeconomic stability, market size, real income levels, the skills base and the quality of the infrastructure (with anonymity of ownership not explicitly referenced as an attractive factor).

182. Moreover, in considering these issues, we should weigh any potential deterrence of investment arising from transparency against the reduced information asymmetry between principals and agents leading to optimal investment and increasing mutually beneficial trades, and a potential increase in the UK's integrity and international reputation as a place to do business and invest. It is not possible, however, to place a monetary value on either any lost investment or the any possible increase. We did note, however, that companies with foreign ownership did not, in the surveyed sample, appear to cite higher costs than other companies for familiarisation or compliance with proposals in the *Transparency and Trust* package. For instance, all costs associated with the prohibition of corporate directors were found not to be statistically significantly different at the 5% level, comparing mean costs of companies with foreign ownership in their ownership chain to those without.

183. In policy terms, we will mitigate the risk of an adverse impact on UK investment by promoting this measure as one of many positive features of the business environment in the UK and continuing to encourage action from other jurisdictions. This will include an active approach in the G8, G20, FATF and in Europe, and wider promotion of the importance of corporate transparency (e.g. through international best practice guidance and standards). This package of policies places the UK at the very forefront of the international transparency agenda. This has already resulted – and will continue to be a key factor – in the UK shaping the international debate and driving international change.

184. There may also be a risk in terms of individuals opting to use non UK companies (rather than UK companies) to facilitate crime, which may still have an impact in the UK. Again this risk will be mitigated by ongoing UK action in the G8, G20, FATF and in Europe to encourage other jurisdictions to take similar action.

207 Beneficial Ownership and Control: A Comparative Study - Disclosure, Information and Enforcement (2013) Vermeulen, E. (2013), OECD Corporate Governance Working Papers, No. 7.
208 *"Going-Private Decisions and the Sarbanes-Oxley Act of 2002: A Cross-Country Analysis*", *USC Center in Law, Economics & Organization Research Paper No. C06-5, USC Law Legal Studies Paper No. 06-10; UC Berkeley Public Law Research Paper No. 901769*Kamar, E., P. Karaca-Mandic and E .L. Talley (2008)

Direct costs and benefits to business calculations (following OITO methodology)

185. The measures the UK has committed to at the G8 are out of scope of One In Two Out on the grounds of implementation being required to meet international obligations.

186. The G8 is a forum that brings together eight global leaders (Canada, France, Germany, Italy, Japan, Russia, UK and USA, alongside the EU) to address international issues and tackle the most pressing global challenges. The G8 Presidency runs for one calendar year and rotates among the eight member countries, giving each member the opportunity to set the agenda and hold the other Leaders to account. The UK held the 2013 Presidency, and the Prime Minister hosted the annual G8 Summit at Lough Erne in June. The agreements and commitments made by G8 leaders are set out in a formal communiqué published at the annual Summit. These commitments are public and binding.

187. At the G8 Summit the UK committed to an Action Plan to prevent misuse of companies and legal arrangements[209] from which the measures set out in this Impact Assessment are drawn. Strong action to deliver a package of reform based on the Action Plan is now the minimum the UK must deliver to meet its international obligations. Each other country has published an Action Plan based on common G8 principles.

188. With respect to accountability for the international commitments the UK has made, the Prime Minister and G8 leaders have publicly agreed to "ensure G8 members are held to account for their commitments,[on which basis] the G8 agrees to a process of self-reporting through a public update on the progress made against individual Action Plans and to inform the Financial Action Task Force [FATF]." A FATF follow-up of the implementation of G8 Action Plans is scheduled for presentation in 2014.

189. In addition, since 2009, the G8 has completed an annual accountability exercise to hold itself to account for the development and development-related commitments which are made at G8 Summits. Every three years a comprehensive report reviews all of the commitments within this scope whilst in the intervening years, the Presidency chooses sectors to include in an in-depth report. Each commitment is scored on a 5 point RAG rating either for the G8 collectively or for individual G8 members depending on the commitment. Moreover, G20 Finance Ministers will report back to G20 Leaders in 2014 on progress made against a commitment in that forum to lead by example to increase transparency of company ownership and control.

190. Although, as international commitments, these measures are not within the scope of One In Two Out, we have, in the interests of good practice, calculated that the preferred option has a net direct cost to business per year of **£3.6m**.

209 June 2013. Documents available on gov.uk https://www.gov.uk/government/collections/g8-communique-and-documents

Wider impacts

Statutory Equality Duties

191. This policy will primarily have an impact on UK companies and their directors. A wider population might derive benefits from the policy as a result of reduced crime or an improved business environment. We have considered whether any of the following groups might be adversely or positively impacted by this policy in different ways:

- Race Equality;
- Gender;
- Disability;
- Age;
- Marriage and civil partnership;
- Religion and Belief;
- Sexual Orientation;
- Gender Reassignment; and
- Pregnancy and Maternity.

192. On analysing the potential impacts, we have no reason to anticipate a particular disproportionate impact on the basis of the key groups highlighted in the Equalities Act 2010. For instance, we have no reason to believe that companies that use corporate directors currently disproportionately involve women, older people or any other group.

Economic Impacts

a. Competition impact test

193. We have considered the potential competition impact of the proposed reforms but this did not identify any particular issues with this policy change.

194. All 3.19 million companies[210] would fall into scope under option one, which would prohibit the use of around 100,200 corporate directorships (1.8% of all directorships), and therefore restrict the organisational form of these companies. A complete prohibition could also theoretically have a disproportionate impact on the sectors which currently use corporate directors. Nonetheless, we do not consider, all other things being equal, this would be a factor in creating any sizeable competitive distortion.

195. Under option two we propose a series of exemptions to a total of at most 900 companies with corporate directors (2.4% of the total). As per option 1, this is not expected to cause any distortion because any companies who need to replace a corporate director can do so at low cost.

196. With respect to both options one and two, we envisage that companies with corporate directors who need to change to comply with the new policy would only suffer a minor cost disadvantage relative to those without. Our estimates indicate that the corporate director could be removed and replaced with a 'natural person' for around £132. Moreover, only 42% of companies with corporate directors reported that they would replace them with a natural person, and 31% said there was no advantage to having one in the first place. As soon as the relatively low to negligible one-off costs of replacing the director are absorbed, the companies which used to have corporate directors could continue business as usual.

210 Company population estimates were extracted from the FAME database (Bureau van Dijk Electronic Publishing, 2013) on 13 December 2013

197. With regard to the impact on smaller entrants relative to large existing companies, the estimated mean costs will not disproportionately fall on small companies. Indeed, there may be pro-competitive effects given that the average costs for small companies are considerably lower than for large, established companies.

b. Small and Micro Business Assessment

198. For the purposes of this assessment, the parameter used to define small businesses is up to 49 full-time employees, and for micro businesses up to 10 employees.

199. As set out above, the two main objectives of the *Transparency and Trust* package are to reduce crime, and improve the business environment so as to facilitate economic growth. The assessment is that excluding small and micro businesses from the policy package could risk a significant impact on the ability of the package to reduce crime, and exclude small and micro businesses from the benefits that can be derived from increased transparency.

200. This policy will apply to all UK incorporated companies (and to LLPs), and will require change from those who currently have or act as corporate directors (or members). There is a default assumption that small and micro businesses[211] should be exempted from new regulatory measures. However, assessment reveals that such an exemption is not viable in this policy context, and not compatible with achieving a large part of the intended benefits of this measure.

201. It has been widely identified that 'shell' companies are often the vehicle of choice for money-laundering and other crimes. A 2012 study defines a shell company thus: "In contrast to operating or trading companies that have employees who make a product or provide a service […] shell companies are little more than this legal identity, and hence the "shell" moniker"[212]. By this very definition, we believe that the majority of shell companies would be classified as small and micro businesses. Law enforcement have strongly confirmed to us that this is the case, and that excluding small and micro businesses from scope would be a significant risk and ultimately counterproductive. Internationally, the USA G8 Action Plan considers targeting small and micro business for selective **inclusion** in scope of company beneficial ownership transparency, and considering larger businesses for exemption where they meet "certain employee or revenue requirements."

202. Allowing any exemptions targeted at small and micro business could therefore have a negative impact on the primary derived benefit from this policy, in terms of a failure to tackle or deter any illicit activity undertaken through existing UK incorporated companies currently on the register. Exempting small and micro businesses from the requirement would create a significant loophole for those seeking to exploit the company structure for illicit activity in future. In turn, this could damage the reputation of UK small and micro businesses relative to their larger and / or international competitors.

203. Moreover, any exemption for small companies would limit the positive impact on the wider building of trust in the business environment - and therefore economic growth. Were they to be exempted from these transparency requirements, information asymmetries could persist and law-abiding businesses might find themselves, for instance, less able to attract private investment or debt finance.

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211 For the purposes of this assessment, the parameter used to define small businesses is up to 49 full-time employees, and for micro businesses up to 10 employees.

212 '*Global Shell Games: Testing Money Launderers' and Terrorist Financiers' Access to Shell Companies*', Findley, Nielson and Sharman, 2012: http://www.griffith.edu.au/business-government/centre-governance-public-policy/research-publications/?a=454625

204. We have undertaken a preliminary analysis of the costs for small companies using the data obtained in the IFF Research company survey. Notably, the costs estimates split by company size do not generate the same total cost figures that we calculated above because they are weighted differently. This ensured that the estimated means were not distorted upwards by the small proportion of companies classified as 'complex' in structure. We will revisit this in the final Impact Assessment to obtain more definitive estimates.

205. Weightings were constructed by the same methodology as for the overall figures except once the data were split into 'small' and 'large' companies, they were weighted only by structure (simple, reasonably complex and complex). As per the overall data, for each truncated mean (99th percentile, 98th percentile etc) the weighting was influenced firstly by the share of companies from the population in each structure classification and the number of remaining observations of each structure classification in the sample.

206. The survey data suggest that the average costs for the small companies with corporate directors will be substantially lower than for large companies, as set out in the table below. These estimates are based on the preferred option and for each cost estimate we have truncated the distribution at the same point as for the estimates for all companies, used above.

207. Companies House figures suggest that over 85% of the 67,000 companies with corporate directors file accounts as if they were small companies[213]. Of overall corporate directorships (including companies with multiple corporate director appointments) 83% of those belong to companies filing accounts as if they were small companies.

Costs	Small company mean	Large company mean
Familiarisation	£125	£202
Removal and replacement for companies with corporate directors	£249	£366
Removal and replacement for companies that are corporate directors	£251	£337

Table 10: Average costs for small companies

208. From the outset we have considered measures to minimise burdens to small and micro businesses, and will continue to develop these as a priority for implementation. As a first step, we will ensure there is sufficient time for companies to familiarise themselves with these changes. We will provide quality guidance, using a variety of media and well-tested and trusted techniques, to begin to operationalise the new system. We will take steps to identify and fulfil any particular guidance requirements of small and micro businesses in order to support them, in particular, in understanding the new requirements. According to further feedback, we will develop this guidance to particularly support those in small and micro businesses who are seeking to take on compliance 'in house' without internal or external expertise. Guidance for the reforms will be tailored to the majority of companies, which are small, simple in structure and law-abiding. This will enable small

213 The proportion of small companies may be higher because they have the option to file full accounts, which would make them appear 'large' in terms of accounts type. This calculation includes accounts that were 'not filed', which generally includes new companies in the first 24 months of their life.

companies to quickly grasp whether or not the prohibition of corporate directors is relevant to them and it will help them to easily assimilate the compliance requirements where they do apply.

209. We will also continue to develop the implementation of the policy change to be as simple as possible for all users but particularly those in small and micro businesses, in terms of interfaces and forms etc. We have not identified any other potential unintended effects to these businesses, and assuming 100% compliance, the impact will not disproportionately impact small and micro businesses.

210. With these points in mind, our assessment against the advised considerations is as follows:

- **Full exemption**

We do not believe a full exemption is compatible with achieving crime reduction benefits; and would reduce benefits derived from a more open and trusted business environment.

- **Partial exemption**

At this stage, we have not identified any specific requirements within the proposals from which we would be able to exempt small and micro businesses. We do not believe any exemption is compatible with achieving a large part of the intended benefits.

- **Extended transition period**

We do not believe a separate transition period for small and micro companies is compatible with achieving a large part of the intended benefits. We will ensure that a sufficient transition period is in place for all companies and that there is sufficient time for a well-supported process of familiarisation and transition.

- **Temporary exemption**

We do not believe a temporary exemption for small and micro companies is compatible with achieving crime reduction benefits, not least because anonymous shell companies are the specific focus of our proposals. Exempting them could therefore provide a means for illicit activity to continue unnecessarily.

- **Varying requirements by type and/or size of business**

As small, anonymous shell companies are the focus of our proposals it would not be appropriate to vary the requirements for small and micro companies. It would also not be appropriate to delineate by sector or any other type of business, since this would produce the same issues in terms of incomplete coverage and loopholes. This would not be compatible with achieving a large part of our intended benefits. Where possible, we have sought to use existing precedents which apply to all UK companies.

- **Direct financial aid for smaller businesses**

We do not believe that the costs of complying with this policy change warrant direct financial aid.

- **Opt-in and voluntary solutions**

We have considered and discounted non-regulatory approaches in our Impact Assessment, given the nature of the criminal activity we seek to address. We do not believe that small and micro companies engaging voluntarily would be a viable solution or compatible with achieving a large part of our intended benefits.

- **Specific information campaigns or user guides, training and dedicated support for smaller businesses**

There might well be a case for tailored information campaigns and user guides, though training is not likely to be required. We will work on meeting the needs of the small and micro business user as we develop overall guidance to support the introduction of the package, and as part of the Government's wider communications campaign.

211. In taking forward these policy objectives, we will consider what support can be offered for the small companies required to make a change to comply with the new regime. Guidance for the reforms will be tailored to the vast majority of companies, which are small, simple in structure and law-abiding. This will enable small companies to quickly grasp whether or not the prohibition of corporate directors is relevant to them and it will help them to easily assimilate the compliance requirements where they do apply.

212. We will continue to develop proposals with a view to a post-implementation review and consider carefully the development of review clauses in legislation. We have considered the value of sunsetting clauses but ultimately view the policy proposals as making longstanding improvements to the UK legal framework. While review and optimisation should continue following implementation, the changes we make must be seen to be enduring in order to deliver the benefits from a reduction in crime and from improvements to the business environment, and particularly in order to meet the UK's international obligations to deliver change in these areas.

Environmental Impacts

a. Rural areas

213. On analysing the potential impacts, we have no reason to anticipate a particular disproportionate impact on rural areas (for instance we have no evidence to suggests companies with corporate directors tend to be located in rural areas).

b. Sustainable Development

214. On analysing the potential impacts, we have no reason to anticipate a particular disproportionate impact on sustainable development (for instance we have no evidence to suggests companies with corporate directors tend to be involved in sustainable development).

Social Impacts

c. Health and well-being

215. As set out in analysis of the options, there are benefits to be derived from this policy change in relation to a reduction in crime and the associated benefits of an increase in wellbeing.

216. We do not, however, see significant scope for impact on safety at work, skills and education, or community facilities.

d. Human rights

217. On analysing the potential impacts, we have no reason to anticipate a particular impact on human rights. The policy measure relates to the actions of companies, and the articles and protocols of the convention do not, in the main, seem relevant here.

218. Article 8 provides for a right to a private life; in seeking to promote the use of natural persons as opposed to corporate directors more information on the roles of individual directors will potentially available, but this will be no more than is currently already available on the vast majority of current directors (around 5.7 million people) in the UK and limited in scope to a number of key fields of information. We therefore understand that there is a limited impact of this policy change on human rights.

Justice Impacts

219. This IA assumes 100% compliance with the policy. A Justice Impact Test is also being completed.

220. We anticipate that we will extend the application of existing company law offences or use existing company law offences as a precedent for the creation of similar offences to deal with instances where a corporate director is appointed when the appointment was outwith the scope of the exemptions from the prohibition.

221. We anticipate however that most instances of non compliance would be dealt with by Companies House through their usual compliance procedures. For example, Companies House estimate that in 85-90% of cases they write to the company in the first instance, before referring the matter to BIS or other enforcement agencies, or taking action themselves.

Devolved Administration Assessment

222. There will be no apparent negative impact on devolved administrations. In fact, given the below data on the proportion of companies with corporate directors and the proportion of directors which are corporate directors, the impact on Scotland and Northern Ireland will be proportionately smaller than on England and Wales and the UK overall.

Share of all companies with corporate directors:

- England and Wales – 2.2%
- Scotland – 1.5%
- Northern Ireland – 1.2%
- UK – 2.1%

Share of all companies acting as corporate directors:

- England and Wales – 1.8%
- Scotland – 1.3%
- Northern Ireland – 0.7%
- UK – 1.8%

Summary and preferred option with description of implementation plan

223. The preferred option is therefore to pursue the prohibition of corporate directors as the default position, with exemptions. This would involve alteration through primary legislation of the Companies Act 2006 provision that all companies should have at least one natural person director. This option would also include the use of regulations to define where companies could be exempted from the prohibition and could use corporate directors. The details of the exemptions to be determined in regulations would be determined by the Secretary of State and approved by Parliament.

224. On the basis of this analysis, it can be seen that option two performs better than option one in terms of having lower quantified transition costs. Moreover, the Net Present Value under option 2 (-£37.3m) is greater than option 1 (-£39.1m). The below table compares the costs and benefits of the two policy options.

Cost/ Benefit	Option 1 (blanket prohibition)	Option 2 (prohibition with some exemptions)	Which option is performs better?
Benefit			
B1. Benefits to government, individuals and business of a reduction in illicit activities	Non-monetised	Non-monetised	N/A

Cost/ Benefit	Option 1 (blanket prohibition)	Option 2 (prohibition with some exemptions)	Which option is performs better?
B2. Benefits to affected companies, individuals and other companies associated with increased economic activity arising from increased transparency	Non-monetised	Non-monetised	N/A
Costs			
C1. Public sector costs	£51,500	£51,500	Tie
C2.The replacement of a prohibited corporate director	£25m £11m for companies £14m for corporate directors	£24m £11m for companies £13m for corporate directors	Option 2
C3. Any resulting disruption, reputational damage and loss of benefits	33,100 companies may be affected	31,300 companies may be affected	Option 2
C4. Familiarisation with the proposals	£14m	£13m	Option 2
C5. Wider economic benefits	Non-monetised	Non-monetised	N/A

225. At the UK-chaired G8 Summit in June 2013, following six months of international negotiation, G8 Leaders recognised the problem of corporate opacity and agreed to publish national Action Plans setting out the concrete steps they would take to address this.

226. The UK published its Action Plan at the Summit, which set out a number of commitments, including with respect to company directors. BIS, as the department with responsibility for company law and corporate governance, is responsible for the implementation of this commitment, working closely with other government departments including HM Treasury and the Home Office.

227. In July 2013 BIS therefore published the Transparency and Trust discussion paper setting out measures to enhance the transparency of UK company ownership. This included proposals to prohibit corporate directors. This Impact Assessment reflects the outcome of that call for evidence, as well as the other evidence gathering mechanisms outlined in this document.

228. In taking forward this policy change, we would seek to pursue the following high level implementation plan :

- This reform necessitates primary legislation. It is therefore our intention to take forward this policy as soon as Parliamentary time allows.
- Once the policy has completed its Parliamentary passage, we would seek to implement along the lines of a plan to be refined as policy is developed and legislation is passed. The plan will include transition arrangements and complement related proposed changes to company law. A potential timeframe is set out below for illustrative purposes and is subject to further development, including in consultation with stakeholders.
    i. Royal Assent
    ii. Exemptions set out in regulations in parallel
    iii. BIS/Companies House issue guidance
    iv. Transition period

v. Companies House operate new systems for newly appointed directors
vi. Companies House operate new system for existing corporate directors
vii. Companies House operate compliance strategy and if necessary enforcement strategy
viii. Post Implementation review established within required timeframe with respect to date of implementation

Annex A – Methodology: The IFF Transparency and Trust Survey

A. Background

1. During consultation on the *Transparency and Trust* discussion paper, to inform policy development and the Impact Assessment process, we have:
   - consulted with the Economic and Social Research Council;
   - consulted with Companies House
   - undertaken a full literature review;
   - opened an online survey accessible by the general public;
   - consulted with business, regulated entities and Law enforcement agencies in a series of focus groups and one-to-ones meetings; and
   - undertaken a large scale company survey

2. On this final point, IFF Research conducted a survey of UK companies on behalf of BIS, starting in August 2013. BIS worked with IFF to develop a mix of qualitative questions and quantitative cost estimates of 574 companies. The survey was intended to examine the impact of proposed corporate transparency reforms on a range of companies, of varying size and ownership structure. Companies were asked questions in order to explore the likely cost impact of establishing a central registry of beneficial ownership, opaque arrangements involving company directors, and the prohibition of corporate directors and the disqualification of certain directors.

3. In order to allow us to derive estimates of costs, the questions asked typically requested information on which members of staff would be involved in a given compliance process and how long it might take, and some direct questions relating to costs.

4. The total cost figures were calculated based on estimates for the number of hours it would take particular employees to comply with the proposals. Once IFF Research compiled these data, they were multiplied by the hourly wage rates taken from the Annual Survey of Hours and Earnings (ONS, 2012). [214]

B. Issues with the survey

5. In depth analysis of the survey methodology and responses has since highlighted several issues. When the survey questionnaire was designed (August 2013), policy was in the early stages of development and remained the subject of consultation. The tight timeframe was necessary in order to inform the policy development and Impact Assessment schedule, but it has meant that the specific requirements of companies (e.g. the nature of familiarisation and compliance) were not fully defined, and therefore were not clearly or comprehensively presented to companies to inform their responses. In fact, IFF Research explained to BIS that some respondents struggled to answer the questions and some had varying interpretations as to what the questions meant for them.

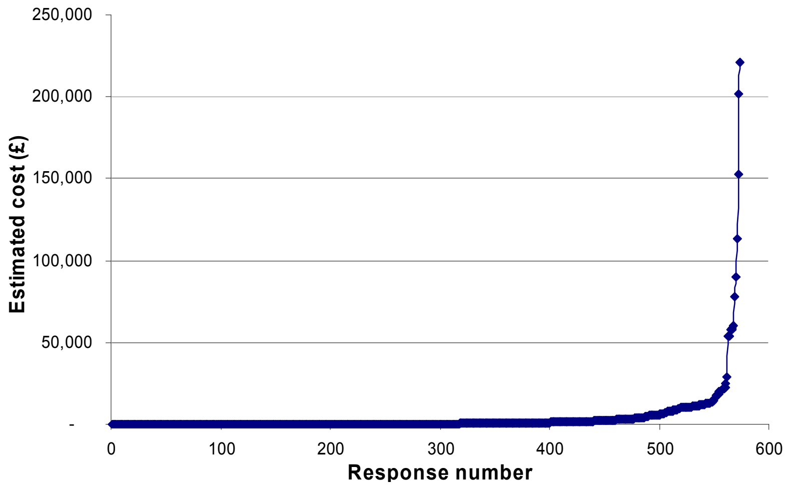
6. **We believe these issues have had an effect on the robustness of the responses and therefore on their overall suitability for unqualified use in analysis of the costs and benefits of the proposed** reforms and their role in our Impact Assessments. These are outlined below.

[214] The statistics taken from ASHE are based on the median rather than the mean. This is the preferred measure of earnings as it is less affected by a relatively small number of very high earners and the skewed distribution of earnings. It therefore gives a better indication of typical pay than the mean. The survey takes a sample of employee jobs drawn from HMRC records of gross pay before tax, National Insurance or other deductions. These data were then uplifted by 17.8% to reflect non-wage costs (i.e. National Insurance, pension contributions, other payroll taxes and other non-statutory employee services such as transport and canteen provision). This is in accordance with Eurostat data and forms a standard assumption.

7. We identified a number of striking distributions across the survey questions. The data we received showed a number of respondents who estimated costs which were extremely high, in contrast to a 'long tail' of respondents who estimated zero costs.

8. For instance, the question relating to familiarisation costs for the creation of a register of beneficial owners, yielded the following distribution of responses:

Figure 1: Distribution of responses on the costs of familiarisation related to beneficial ownership.



Staff Cost (£)		Additional costs (£)		Total costs (£)	
Mean	Median	Mean	Median	Mean	Median
1,087	145	1,124	0	2,211	196

Table A1: Familiarisation costs related to beneficial ownership

9. Close interrogation of this 'tail' of high responses has not indicated any discernible pattern; that is to say, the companies which gave high responses did not consistently adhere to any identifiable characteristics. We might have expected higher costs for larger and more complex companies, but in the context of analysis of these respondents there was no relationship between cost[215] and size (based on turnover, employees and assets) and complexity (based on the number of layers of share ownership).

10. If we compare the estimates of familiarisation costs produced by the present survey to other estimates of familiarisation costs, they are revealed to be noticeably higher. Recent modelling from Companies House[216], indicates that the familiarisation costs for a broadly comparable measure are substantially lower; modelling indicated it would take companies 20 minutes to familiarise themselves with a comparable policy, which was multiplied by £19 – the mid point between the median wage and the wage of a company director – to give a total familiarisation cost of around £6. Discussion with business representative organisations suggested that estimates based on these parameters were likely to be reasonable.

215 Although there was a slight tendency for those giving high responses to be 'large' – around 60% were.
216 Detail in cost benefit analysis within consultation on Companies House Filing Requirements (October 2013, BIS).

11. We identified similar differences when comparing other parts of this survey to wider evidence; the ongoing costs of complying with the policy also appear to have been significantly overestimated. The present survey estimated costs for companies providing information on beneficial ownership to Companies House each year (as one part of the total ongoing costs) as set out below:

Staff Cost (£)		Additional costs (£)		Total costs (£)	
Mean	Median	Mean	Median	Mean	Median
212	48	149	0	361	48

Table A2: Costs of reporting beneficial ownership to Companies House

12. The estimates in Table 2 are at odds with another previous estimate. In 2007, PWC were commissioned to produce an Administrative Burdens Measurement Exercise. This exercise estimated administrative burden of regulations across a number of policy areas. PWC estimated the cost of completing, signing and returning a Companies House form (form 69280) to be £10.73 per company, which uprated to 2013 prices is £12.39. This process is broadly comparable to the some of the requirements in the *Transparency and Trust* package (such as reporting simple information on beneficial ownership to Companies House) but, again, the IFF estimates look inexplicably high[217].

13. The early stage of policy development to inform question design was perhaps compounded by the fact that the in some cases the policy measures in question were proposed to apply to a relatively small proportion of the population. As such, it was not always possible to directly target the population of interest when constructing the sample, and some questions were hypothetical.

14. In addition, respondents who gave extreme values were not asked further questions to allow us to understand what drove their estimates. Analysis showed that the majority of the costs were driven by very high responses to questions relating to “additional costs” (as shown in Table 1); that is costs identified by companies in addition to staff time. These were quoted in asking the question as ‘legal, third party costs, etc.’ but the exact detail of what companies thought they would involve was not determined.

15. For the reasons set out above, we now believe that the survey questions which asked for cost estimates lacked the specificity required to elicit fully informed or meaningful answers. The combination of the methodological concerns, the discrepancy between different respondents and between these and other analyses points to the need for further analysis to understand the costs to business of these reforms. This is particularly the case since we are continuing to refine the policy.

16. We have used statistical techniques for this iteration of the Impact Assessment to adjust the impact of extreme values. The steps we have taken to process the data for use in the present Impact Assessment are set out below. We will pursue further analysis as a priority for the final stage Impact Assessment.

C. Methodology for the current Consultation Impact Assessment

17. Despite its flaws, the survey is the most comprehensive dataset available, and we believe there is value in processing it to produce realistic and duly qualified cost estimates. As an interim measure, for this iteration of the Impact Assessment, we have truncated the mean to adjust for extreme

[217] For instance, the response to the survey question “Costs as a result of providing beneficial ownership information to a central register on an annual basis” yielded an unadjusted mean response of £160 – more than twelve times higher than the PWC figure for a similar process.

values[218]. As context for doing so, we have considered the evidence from sources as discussed above and our conversations with business representative organisations. We have also considered the issue of additional costs.

18. Firstly it is necessary to consider and exclude zero values from the estimated mean (which will have the consequence of increasing our estimated costs). A large number of survey respondents answered that there would be zero costs arising from the proposed policy changes. This seems counter-intuitive, because all companies would need to spend at least some time understanding a form, even if just to determine that no or limited action is necessary. Therefore these observations have been removed, in accordance with the standard BIS approach to estimating costs to business. We will test this overall assumption with respect to each question or facet of the costs in further research, which will feed in to the final version of the Impact Assessment.

19. It is also necessary to exclude implausible or unverifiable estimates at the opposite end of the distribution. We used the truncated mean for each survey question relating to costs based on the shape of the relevant distribution (i.e. truncating the mean where the costs go beyond what we would consider feasible on a question by question basis).

20. The aim of these two changes is to deliver a more realistic cost estimate to apply to the general population of companies.

21. The next issue relates to whether the responses to questions around additional costs should be included. As set out above, the responses to the non- staff costs were implausibly high when compared with other evidence sources. The question was open-ended and did not define the sorts of costs that should be included, and IFF reported that there were very significant differences in interpretation of these questions across respondents, with some highly unusual interpretations. They were clear that the lack of question specificity was a particularly acute issue with these questions. Therefore we decided to exclude these responses from our analysis. We intend to return to this issue in the further analysis which we will commission for the next iteration of the IA.

22. Below we analyse the total economic costs of the proposals relating to the prohibition of corporate directors under option 1 for simplicity. The table below only considers staff costs on the basis that non-staff costs should be excluded, as detailed above. Mean costs were input into the 'best estimate' model described in the main body of this Impact Assessment to produce total cost to business estimates.

23. The raw sample data were weighted according to their size and structure (as per the share of all companies in each of the 6 cells in the 3x2 grid) and according to the number of observations of each of the 6 company types in the sample. The process was as follows:
    i) Percentage of the population in each of the 6 cells x number all sample observations (excluding zeros and truncated observations)
    ii) Total number of non-zero truncated sample observations for each of the 6 cells
    iii) Divide (i) by (ii)

24. This calculation was necessary for each truncated mean and for each cell because once the data were truncated, a given number of observations were removed from the sample. The weightings, therefore, needed to be adjusted for each truncation to ensure that raw sample data were not inappropriately weighted after observations were removed.

218 A truncated mean discards the 'extreme values' to use only the feasible values in the sample in the estimated mean.

25. The table below indicates that mean familiarisation costs of £500 alongside £769 for removal and replacement for a company with a corporate director and £798 for the removal and replacement of a company which is a corporate director. This produces a total cost of £217m. Once the top 1% of data are truncated (and the zero responses are excluded as per all of the truncated means) the estimated total cost to business falls substantially to £78m.

26. Our analysis of the individual distributions for each of the three costs led us to truncate the mean at the 98th percentile for familiarisation, the 96th percentile for removal and replacement costs and the 98th percentile for removal and replacement costs for companies which are corporate directors. As detailed in the above text, this yielded total costs to business of £39m.

27. We have conducted some sensitivity analysis around our 'best' estimates by using a truncated mean one percentile either side of the central estimate. For instance, for familiarisation our 'high' estimate was £129 (99th percentile truncated mean) and our 'low' estimate was £74 (96th percentile truncated mean).

	Familiarisation (£)	**Companies with a corporate director -removal and replacement (£)**	**Companies which are a corporate director -removal and replacement (£)**	**Total Cost to Business (£m)**
Mean staff cost	500	769	798	217
Mean staff cost excluding zero responses	814	1079	1124	322
99th percentile - truncated	129	390	257	78
98th percentile - truncated	**96**	235	**139**	48
97th percentile - truncated	74	166	105	35
96th percentile - truncated	60	**132**	84	28
95th percentile - truncated	48	103	64	22
94th percentile - truncated	40	81	53	18
93rd percentile - truncated	34	66	45	15
92nd percentile - truncated	30	56	39	13
91st percentile - truncated	25	48	35	11
90th percentile - truncated	20	42	30	10
89th percentile - truncated	17	37	26	8
88th percentile - truncated	14	33	23	7
87th percentile - truncated	12	30	20	6
86th percentile - truncated	10	26	18	5
85th percentile - truncated	9	24	15	5

Table A3 : Truncation of the sample – top percentiles

28. This approach has limitations because we are losing a significant number of observations with corresponding impacts on the standard errors. The trimmed observations will be lost from both the top end of the distribution (where we are truncating based on the percentiles detailed in the table) and from the bottom end (where we have excluded all zero observations). Table A4 details this.

	Number of zero observations	Zero observations as % of all observations	Truncated mean percentile
B3. Costs as a result of company familiarisation with the proposed reforms	67	12%	85th
C2. Costs as a result of identifying and collecting information about the beneficial owner.	387	67%	90th
C3. Costs as a result of responding to a request about your beneficial ownership.	185	32%	95th
C4. Costs as a result of collation, process and storage of beneficial owners data	162	28%	94th
C5. Costs as a result of updating beneficial ownership information on an annual basis	119	21%	85th
C7. Costs as a result of providing beneficial ownership information to a central register on an annual basis.	76	13%	85th
D1. Costs as a result of ensuring your company is familiar with proposed reforms to prohibit corporate directors.	186	32%	98th
D7. Costs as a result of removing and then replacing the corporate director.	147	26%	96th
D8. Costs as a result of removing or updating your corporate directorship.	165	29%	98th

Table A4 : Truncation of the sample – zeros and top percentiles

29. However, the alternative to using the survey data would be to rely on other estimates which are limited in scope, and leave substantial gaps in the evidence base. For this reason, our view is that the only feasible approach is to use the adjusted survey data as discussed above, and we have therefore adopted this approach consistently throughout our analysis.

Annex B : Consideration of illustrative examples of exemptions from a prohibition of corporate directors under Option Two

- Listed companies on an EU regulated market in large group structures

When companies apply to the Main Market of the London Stock Exchange they must first produce a prospectus for review by the UK Listings Authority. The Financial Conduct Authority oversees its admission to ensure they abide by the appropriate disclosure standards. Thereafter, companies are subject to thorough reporting obligations, as detailed by London Stock Exchange (2013)[219]. Listed companies are also required to comply (or explain their non-compliance) with the Financial Reporting Council's Corporate Governance Code. These sorts of companies might also derive the most legitimate benefit from corporate directors for the purposes of co-ordination across the broad range and diversity of companies in their large group structures, encompassing a large number of companies.

- Large private companies in group structures

Large private companies in group structures are also likely to pose a lower risk of perpetrating illicit activity relative to smaller private companies; their size and established status likely represent a genuine contribution to the economy rather than a front for criminals. These sorts of companies also derive legitimate benefit from corporate directors for the purposes of co-ordination across companies in their group structures.

- Charity companies

Charities can take different legal structures including companies. The Charity Commission is the registrar and regulator of charities in England and Wales, which can use quasi judicial powers aimed at protecting the public's interest in the integrity of charity. The Office of the Charity Regulator in Scotland and the Charity Commission for Northern Ireland perform similar regulatory functions, to underpin the charity sector. While they are therefore regulated, charities structured as companies are likely *also* to derive particular benefit from corporate directors and their professional expertise, since they might suffer particular barriers to engaging individuals.

- Pension funds

Pension funds can also take different legal structures. The Pensions Regulator is the relevant regulator across the UK, which can use its regulatory powers, including detective and remedial powers and penalties, to protect the members of pension schemes and promote better understanding of effective pension administration. Again, pension funds are likely to be closely regulated and to derive benefit from corporate trustees and directors, whose professional expertise and wide representation is an advantage relative to engaging an individual.

219 www.londonstockexchange.com/companies-and-advisors/main-market/documents/brochures/admission-and-disclosure-standards.pdf

Title: Prohibiting Bearer Shares in UK Companies **IA No:** RPC13-BIS-1987 **Lead department or agency:** Department for Business, Innovation and Skills (BIS) **Other departments or agencies:** Companies House (CH), Her Majesty's Treasury (HMT), Her Majesty's Revenue and Customs (HMRC), and the Ministry of Justice (MoJ)	**Impact Assessment (IA)** **Date:** 16 April 2014 **Stage:** Consultation Stage **Source of intervention:** International **Type of measure:** Primary legislation **Contact for enquiries:** Transparency and Trust team Tel: 020 7215 0906 Email:TransparencyandTrust@bis.gsi.gov.uk

Summary: Intervention and Options

RPC Opinion: Amber

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, Two-Out?**	**Measure qualifies as**
-£1.34m	-£1.3m	£0.13m	No	NA

What is the problem under consideration? Why is government intervention necessary?

Opacity of the control of corporate structures can firstly facilitate illicit activity, and secondly lead to a deficiency in corporate governance which erodes trust and damages the business environment. Both can ultimately hold back economic growth. Government intervention is necessary to correct the regulatory failure underpinning the first, and the information asymmetry reflected in the second. Bearer shares are a means through which the record of an individual's ownership of a stake in a company can be avoided. Individuals can therefore conceal their control or transfer their control anonymously.

What are the policy objectives and the intended effects?

The objectives and intended effects of our chosen policy option are to:

- improve our understanding, in conjunction with the wider *Transparency and Trust* measures, of who really owns and controls UK companies and so prevent the potential for their misuse; and
- ensure that the UK fully meets Global Forum on Tax Transparency and Financial Action Task Force (FATF) standards on bearer shares activity.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Three options have been considered: maintaining the current situation (*Option 0*); abolishing bearer shares (*Option 1: the recommended option*); and a mandatory custodian arrangement (*Option 2*).

Option 2 has lower quantified transition costs than Option 1, because it does not require shares to be converted (and share conversion imposes costs on bearer share owners and issuers).

However, we recommend Option 1 because firstly it has greater unquantified benefits around stimulating economic activity; and secondly the Net Present Value is much more favourable (-£1.34m compared with -£8.19m under Option 2), primarily because it does not require the large ongoing costs associated with Option 2.

Will the policy be reviewed? It will be reviewed, pending determination of appropriate timeframes with respect to passage of primary legislation (e.g. within five years of coming into force).

Does implementation go beyond minimum EU requirements?			N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** Yes	**< 20** Yes	**Small** Yes	**Medium** Yes	**Large** Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** 0	**Non-traded:** 0	

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister: Jerry L Sikett Date: 5 March 2014

Summary: Analysis & Evidence Policy Option 5: Recommended

Description:

FULL ECONOMIC ASSESSMENT

Price Base Year 2013	PV Base Year 2013	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: Optional	**High:** Optional	**Best Estimate:** -1.34

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate	1.3		0	1.3

Description and scale of key monetised costs by 'main affected groups'

Transition costs. There are costs to both bearer shareholders (£288k) and bearer share issuers (£75k) to becoming familiar with the policy change. There are also costs to bearer shareholders in identifying themselves to the company and converting the shares (£41k). There are legal costs to bearer share issuing companies to convert the shares into registered shares or cash (£840k). Lastly, there is a cost to government of implementing and publicising the changes (£40k).
Ongoing costs. There are yearly costs of £6k due to the reduction in the ease of transferability to bearer shareholders arising from abolition.

Other key non-monetised costs by 'main affected groups'

There are **non-monetised costs** associated with potentially higher financing costs to companies who issue bearer shares who are now no longer able to sell equity at a relative discount to those purchasers who value the anonymity and transferability associated with these securities. There are also non-monetised search costs in terms of bearer share issuing companies being required to locate bearer shareholders.

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate	0		0	0

Description and scale of key monetised benefits by 'main affected groups'

None of the benefits can be monetised. See below for description on non-monetised benefits.

Other key non-monetised benefits by 'main affected groups'

There are **non-monetised benefits** to companies that currently issue bearer shares, individuals and other companies associated with increased economic activity arising from greater transparency. There are also benefits to government, individuals and business of a reduction in illicit activities.

Key assumptions/sensitivities/risks **Discount rate (%)** 3.5

Almost by definition, corporate opacity is challenging to evaluate; we have taken considerable steps to identify material to support quantification of the costs and benefits of the proposals, and have used evidence derived from a survey of 600 companies. We received a large number of both high and zero cost estimates in the survey so the sample was truncated to arrive at more robust and representative estimates. We have conducted some sensitivity analysis around our estimates.

BUSINESS ASSESSMENT (Option 5)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs: 0.1	**Benefits:** 0	**Net:** -0.1	No	NA

Summary: Analysis & Evidence Policy Option 6

Description:

FULL ECONOMIC ASSESSMENT

Price Base Year 2013	PV Base Year 2013	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: Optional	**High:** Optional	**Best Estimate:** -.8.19

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate	0.4		0.9	8.2

Description and scale of key monetised costs by 'main affected groups'

Transition costs. There are costs to both bearer shareholders (£288k) and bearer share issuers and banks (£105k) to becoming familiar with the policy change. Lastly, there is a cost to government of publicising the changes (£1k).

Ongoing costs. There are ongoing costs of £6k per year due to the loss of transferability to bearer shareholders arising from immobilisation. There are also ongoing costs, associated with custodian banks being required to maintain custody of bearer shares, of £900k per year.

Other key non-monetised costs by 'main affected groups'

There are **non-monetised costs** associated with potentially higher financing costs to bearer share issuing companies who are now no longer able to sell equity at a relative discount to those purchasers who value the transferability associated with these securities.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate	0		0	0

Description and scale of key monetised benefits by 'main affected groups'

None of the benefits can be monetised. See below for description on non-monetised benefits.

Other key non-monetised benefits by 'main affected groups'

There are non-monetised benefits to government, individuals and business of a reduction in illicit activities and increased economic activity.

Key assumptions/sensitivities/risks **Discount rate (%)** 3.5

Almost by definition, corporate opacity is challenging to evaluate; we have taken considerable steps to identify material to support quantification of the costs and benefits of the proposals, and have used evidence derived from a survey of 600 companies. We received a large number of both high and zero cost estimates in the survey so the sample was truncated to arrive at more robust and representative estimates. We have conducted some sensitivity analysis around our estimates.

BUSINESS ASSESSMENT (Option 6)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs: 0.8	Benefits: 0	Net: -0.8	No	NA

Evidence Base (for summary sheets)

Executive summary

Problem under consideration and rationale for intervention

- At the UK-chaired G8 Summit in 2013, the G8 Leaders recognised the problem of corporate opacity and agreed to publish national Action Plans setting out the concrete steps they would take to address this. The UK's Action Plan set out a number of commitments, including the commitment to review corporate transparency in relation to bearer shares.
- Corporate opacity can facilitate illicit activity, and lead to poor corporate oversight behaviour which erodes trust and damages the business environment. Both crime and a lack of trust can impede economic growth.
- Where there is a lack of transparency around corporate structures which facilitates illicit activity and hinders the criminal justice system, there is **regulatory failure** with respect to the company law framework and enforcement. Where there is a lack of transparency, there is an **information asymmetry** which damages trust and hinders transactions and investment. Therefore there is a dual rationale for government intervention to address the problems of corporate opacity.
- The central problem under consideration is therefore the scope for misuse and mistrust in the current legal framework which provides a way for individuals to hold an interest in a company without having to provide details on the company's register of members which would allow their identification. The bearer shares 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. Bearer shares are therefore untraceable and can be transferred without record.

Policy objectives and options

- The overarching policy objectives for the *Transparency and Trust* package are to reduce crime and improve the business environment so as to facilitate economic growth.
- Specifically, the objective of this policy is to ensure that the UK fully meets Global Forum on Tax Transparency and the Financial Action Task Force standards on bearer shares activity.
- Three options are considered: Option 0) maintaining the current situation; Option 1) abolishing bearer shares; and Option 2) a mandatory custodian arrangement.
- **Option 0** includes:
    - Maintaining the current situation. This does not achieve the stated policy objectives.
- **Option 1** includes:
    - Prohibiting the creation of new bearer shares to prevent the potential for misuse; and
    - Providing a set period of time for holders to convert existing bearer shares to registered shares.
- **Option 2** includes:
    - Existing bearer shares being held by a bank under a custodian arrangement; and

- Potentially also prohibiting the creation of new bearer shares.

Costs and Benefits

Option 1, the recommended option, has the following costs and benefits:

- There are **non-monetised benefits** to affected companies issuing bearer shares, individuals and other companies associated with increased economic activity arising from increased transparency. There are also benefits to government, individuals and business of a reduction in illicit activities.
- There are **transition costs** to both bearer shareholders (£288k) and bearer share issuers (£75k) to becoming familiar with the policy change. There are also costs to bearer shareholders in identifying themselves to the company and converting the shares (£41k). There are legal costs to bearer share issuing companies to convert the shares into registered shares or cash (£840k). Lastly, there is a cost to government of implementing and publicising the changes (£40k).
- There are yearly **ongoing costs** of £6k due to the reduction in the ease of transferability to bearer shareholders arising from abolition.
- There are **non-monetised costs** associated with potentially higher financing costs to bearer share issuing companies no longer able to sell equity at a relative discount to those purchasers who value the anonymity and transferability associated with bearer shares. There are also non-monetised search costs in terms of bearer share issuing companies being required to locate bearer shareholders.

Option 2 has the following costs and benefits:

- There are **non-monetised benefits** to government, individuals and business of a reduction in illicit activities.
- There are **transition costs** to both bearer shareholders (£288k) and bearer share issuers and banks (£105k) to becoming familiar with the policy change. Lastly, there is a cost to government of publicising the changes (£1k).
- There are **ongoing costs** of £6k per year due to the loss of transferability to bearer shareholders arising from immobilisation. There are also ongoing costs, associated with custodian banks being required to maintain custody of bearer shares, of £900k per year.
- There are **non-monetised costs** associated with potentially higher financing costs to bearer share issuing companies who are now no longer able to sell equity at a relative discount to those purchasers who value the transferability associated with these securities.

A. Background

A lack of corporate transparency

1. Under the Presidency of the UK, G8 Leaders agreed at Lough Erne in June 2013 that a lack of corporate transparency was a problem they were determined to address. This corporate opacity might come from a lack of transparency around who ultimately owns and controls the company (i.e. its beneficial owners), or from the use of bearer shares or opaque arrangements involving company directors. The G8 described these problems thus:

   "A lack of knowledge about who ultimately controls, owns and profits from companies […] not only assists those who seek to evade tax, but also those who seek to launder the proceeds of crime, often across borders. Shell companies can be misused to facilitate illicit financial flows stemming from corruption, tax evasion and money laundering. Misuse of shell companies can be a severe impediment to sustainable economic growth and sound governance. We will make a concerted and collective effort to tackle this issue and improve the transparency of companies […] Improving transparency will also improve the investment climate; ease the security of doing business and tackle corruption and bribery. It will support law enforcement's efforts to pursue criminal networks, enforce sanctions, and identify and recover stolen assets. We are determined to take action to tackle the misuse of companies […][220]."

2. The G8 Leaders each agreed, and have now published, national Action Plans setting out the concrete steps they would take to address the misuse of companies. Specifically, these Action Plans consider the need to tackle the issue of the misuse of bearer shares. The G8 commitments are in line with the recommendations of the Financial Action Task Force (FATF), which sets the global standards on combating money laundering and terrorist financing: *"Countries must also take specific measures to prevent the misuse of other mechanisms that are frequently used to disguise ownership of companies, including bearer shares*." The Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum) has also identified bearer shares as a key means of facilitating tax evasion and money laundering and recommended the UK take action.

3. In July 2013, the Department for Business, Innovation and Skills (BIS) published its *Transparency and Trust* discussion paper. In it, we considered a range of proposals to enhance the transparency of UK company ownership and increase trust in UK business, including a proposal to prohibit the use of bearer shares by UK companies. As set out in the paper, *"Business success – and therefore economic growth – depends on investors, employees, consumers and wider public having confidence in business. When companies do business with each other, those transactions must also be built on trust.[221]"*

4. Legal owners of a company are recorded on the company's register of members. Currently, a company can however issue a share warrant to bearer in respect of shares of the company ('bearer shares'), which has the legal effect that the shares 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. Bearer shares therefore provide a way for individuals to hold an interest in a company without being recorded on the register in a way which allows their identification, and to transfer shares without record. Historically, this ease of transferability may have been a key comparative advantage to ordinary, registered shares where physical transference of the share

[220] 2013 Lough Erne G8 Leaders' Communiqué (June 2013): https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/207771/Lough_Erne_2013_G8_Leaders_Communique.pdf.
[221] BIS, July 2013: https://www.gov.uk/government/consultations/company-ownership-transparency-and-trust-discussion-paper.

warrant was a significantly faster process than transfer of ordinary registered shares. Modern usage of electronic share registration for ordinary shares has however considerably reduced this advantage. As a fundamental feature of bearer shares is that they do not belong to registered members, they cannot be held electronically.

5. Whilst bearer shares may be used for legal purposes 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. We therefore consider that it is appropriate to prohibit the creation of new bearer shares, and abolish existing bearer shares, to prevent the potential for misuse.

6. This Impact Assessment accordingly considers the costs and benefits of prohibiting UK companies from issuing bearer shares. Other Impact Assessments in the *Transparency and Trust* package cover proposed action to improve the transparency of ownership and control of companies through other means. Taken together, these measures should meet the overarching G8 objectives to tackle the misuse of companies.

B. Problem under consideration

7. The UK's G8 commitments capture the two sides of the problem under consideration – firstly, that of opacity facilitating illicit activity, and secondly that of a deficiency in good corporate behaviour which erodes trust and damages the business environment. Both elements can ultimately hold back economic growth.

Corporate opacity and illicit activity

8. As an indication of the scale of this type of criminal activity, the European Commission's 2013 Impact Assessment of *'Anti-Money Laundering and Terrorist Financing'*[222] points to global criminal proceeds potentially amounting to some 3.6% of GDP; around US$2.1 trillion in 2009. The best available international estimate of the amounts used in just money-laundering would be equivalent to some 2.7% of global GDP or US$1.6 trillion in 2009[223].

9. Illicit financial flows reflect and result in significant global challenges; illicit flows out of low income countries, particularly in Africa, are sizeable. It is often noted that these countries lose billions of dollars per year in illicit financial flows. Though almost by definition figures are difficult to derive, the Africa Progress Panel chaired by Kofi Annan[224] highlighted the problem, citing research suggesting that the annual loss to Africa between 2008 and 2010 was $38bn, and that between 1970 and 2008 $1.8 trillion were lost from the continent - with obvious human consequences[225]. Moreover, as the National Organised Crime Strategy (2013) sets out, *"overseas, organised crime undermines good governance and the stability of countries of strategic importance to our national security. Organised crime groups overseas can facilitate or engage in terrorism."* Reducing the potential for illicit financial flows, including through misuse of the company structure, is therefore one means of countering significant international problems.

222 European Commission (2013) for revision of the third money laundering directive 'Impact Assessment – proposal on the prevention of the use of the financial system for the purpose of money laundering, Including terrorist financing'

223 Estimating illicit financial flows resulting from drug trafficking and other transnational organized crimes: Research report. UNODC (October 2011). This estimate would be within the IMF's original 'consensus range', equivalent to some 2.7 % of global GDP (2.1 – 4 %) or US$1.6 trillion in 2009.

224 'Africa Progress Report 2013: Equity in Extractives' Africa Progress Panel (2013)

225 'Illicit Financial Flows from Africa: Hidden Resources for Development' Global Financial Integrity and the African Development Bank (2013)

10. There is a clear link between such illicit financial flows and company structures, described with concern by a range of international expert organisations. The Organisation for Economic Co-operation and Development (OECD; 2011)[226] has observed that *"almost every economic crime involves the misuse of corporate vehicles [i.e. companies]."* A World Bank review[227] of 150 cases of grand corruption identified the use of companies in the majority. Meanwhile, the World Economic Forum (WEF; 2013)[228] highlighted the increasing number of problematic cases confronting law enforcement agencies involving illegitimate business activity co-mingling with legal business activity, and funds with illicit funds.

11. These issues are systemic and relate in many ways to the essence of the company form, which is largely replicated throughout international legal systems. Given the significant international issues, and the high profile association of some jurisdictions with illicit financial flows, the UK is driving change on a wider stage. The Government is pursuing this not only through the G8, as mentioned, but also in the G20, in the Financial Action Task Force (FATF), in Europe, and with the UK's Overseas Territories and Crown Dependencies. In parallel, there is a strong case for domestic action to reduce the vulnerability of the company form.

12. With respect to the UK, directly applying the 2009 global estimates as set out above (which may or may not be representative) would equate to around £42bn of laundered money in 2012. The social and economic costs of organised crime in the UK are estimated to be £24bn[229], of which £8.9bn are associated with fraud. The misuse of the company structure described as a general principle above applies equally in the UK and contributes to our issues as it does internationally.

13. In 2011, the Financial Services Authority[230] (in their role now assumed by the Financial Conduct Authority) published an assessment of how banks manage money laundering risk including where it arises from the use of UK incorporated companies; they described an example where *"Company A is a UK incorporated company which has an account with the private banking arm of a major UK group."* The bank had determined the ultimate beneficial owner of Company A as *"a PEP [politically exposed person] whose husband is a former politician from a higher risk country."* In this situation, the bank's processes led it to terminate the relationship.

14. This connection between crime and the company structure can be demonstrated yet more vividly by recent examples. Within one month of the G8 Summit last year, eight people were found guilty following an investigation by North Yorkshire Police's Major Fraud Investigation Team and Her Majesty's Revenue and Customs (HMRC) which showed the use of a series of companies to launder the proceeds of a £1.28m theft from the Department for the Environment, Food and Rural Affairs (DEFRA) and attempt a £250,000 VAT fraud[231]. Earlier in 2013, two people were found guilty, following an investigation by the Serious Fraud Office (SFO), of using deception and forgery including the use of company structures to perpetrate a fraud worth millions of pounds[232].

15. On the basis of the current opacity and misuse of the company structure, a strong case for action to increase corporate transparency has been made by the UK's law enforcement agencies. The

226 'Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes'. OECD (2011)

227 The Puppet Masters : How the Corrupt Use Legal Structures to Hide Stolen Assets and What to do About It. World Bank Publications 2011.

228 'Organised Crime Enablers' World Economic Forum (2013) *"Law enforcement agencies have been handling an increasing number of cases in which legitimate businesses co-mingle with illegal businesses, and legitimate funds with illicit funds. Reconstructing these complex corporate schemes and identifying who lies behind them, i.e. identifying their beneficial owners (BO), is considered to be essential to reveal the full extent of the criminal infrastructure and to prevent future criminal activities."*

229 Home Office (October 2013): *Serious and Organised Crime Strategy.* This estimate does not include money laundering.

230 " Banks management of high money-laundering risk situations" (June 2011).

231 http://www.northyorkshire.police.uk/11613

232 http://www.sfo.gov.uk/press-room/latest-press-releases/press-releases-2013/achilleas-kallakis-and-alexander-williams-jailed.aspx

SFO, the National Crime Agency (NCA)[233], the Crown Prosecution Service (CPS), HMRC and various branches of the police have been engaged in the development of the package and this Impact Assessment and have described the problems the *Transparency and Trust* package could address and the benefits it could bring for them, and crucially for business and the public from a potential reduction in crime[234].

Corporate opacity and corporate governance

16. *"High quality corporate governance helps to underpin long-term company performance. The UK has some of the highest standards of corporate governance in the world, which makes the UK market attractive to new investment."* This widely held view has been captured here by the Financial Reporting Council, the UK's independent regulator responsible for promoting high quality corporate governance and reporting to foster investment. But keeping the UK's position secure requires continual evaluation of improvements that can be made.

Specific problems associated with bearer shares

17. Currently in the UK company law, when a company issues ordinary 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 available publicly on request, subject to a court-based process for determining non-disclosure where the information is sought for improper purposes. This ensures transparency of legal ownership of UK companies.

18. There are however ways in which legal owners of shares can conceal their identity. If allowed by its own Articles of Association, 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'.

19. The legal ownership of a bearer share can be transferred from one individual 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[235]. However, in practice the holder could request this to be done by an intermediary, such as a solicitor, therefore maintaining the true beneficiary's anonymity.

20. Analysis indicates that 1233 UK companies have issued bearer shares, of which around 787 are still trading, the remainder being dormant. From a total population of 3.19 million companies, this figure represents 0.04% of companies so the corresponding impact of reform, in terms of the costs and benefits outlined below, will be relatively small[236].

21. Of an initial sample of 459 UK companies with bearer shares, the proportion of bearer shares varied from 4% to 100%. From this small sample 99% of companies were entirely owned by bearer shareholders[237].

233 And previously the Serious Organised Crime Agency (SOCA)

234 Evidence provided by the Serious Organised Crime Agency prior to the launch of the National Crime Agency in October 2013.

235 Companies Act 2006, section 779 (3) 'A company that issues a share warrant may, if so authorised by its articles, provide (by coupons or otherwise) for the payment of the future dividends on the shares included in the warrant.'

236 Companies House data 2013

237 Response to BIS consultation letter

22. The very nature of bearer shares – i.e. the lack of any record of ownership – prevents us from identifying how many individuals own the bearer shares in each company. It would be feasible, for instance, for one individual to own five million shares in the same company.

i. The scope for misuse

23. Bearer shares may be used to conceal ownership for lawful purposes:

- if a company were involved in controversial activities (for example, animal testing research) and the shareholders had concerns about harassment and physical harm; and
- 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 often seek to retain their anonymity to avoid the awareness of the target company.

24. However, the complete anonymity of legal ownership, without even the potential for law enforcement to pursue a paper trail and with infinite transferability, 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.

25. It is clear that the lack of transparency derived from bearer shares and facilitating illicit activity is inconsistent with the Government's stated aim[238] to improve our understanding of who owns and controls UK companies.

26. The case for action in the UK is supported by evidence provided in response to the *Transparency and Trust* discussion paper on the proposal to prohibit bearer shares[239]. Some respondents noted that some company service providers offer to form "UK bearer shares companies," that is to say, companies owned entirely by anonymous share warrants, listing the selling point as the ability of such companies to hide the true owners of the company. Since some countries[240] have already prohibited the use of bearer shares, some might seek to incorporate their company in the UK to take advantage of the ability to issue bearer shares – even if they are not conducting illicit business there is no guarantee they will be incorporating in the UK to conduct economic activity here.

27. It should be noted that there are current legislative means to identify the holders of bearer shares in UK companies. However these are not compliant with current international standards. The Secretary of State can use his statutory powers to investigate company ownership under sections 442 or 444 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. However, the methods are labour-intensive and expensive, and in addition to the Global Forum on Transparency and Exchange of Information for Tax Purposes non-compliance, result in an overall deficit in transparency. The fact that these powers are not open to law enforcement agencies to use without disclosing confidential information is also a core weakness.

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[238] https://www.gov.uk/government/news/cable-announces-proposals-to-radically-improve-company-transparency-and-boost-public-trust-in-business.
[239] *Transparency and Trust* Discussion Paper, 2013.
[240] E.g. Panama and the Cayman Islands.

28. Without Government intervention, there is unlikely to be sufficient collective action by industry to address these issues; particularly given the criminal nature of the activity we are aiming to address.

ii. The need for change

29. The Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum) and the Financial Action Task Force (FATF) have both identified bearer shares as key means of 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".*

30. Under the UK's G8 Presidency in 2013, G8 members recognised the need to take action on bearer shares to ensure full transparency of company ownership. The "Principles on preventing the misuse of companies" agreed by G8 Leaders in June 2013 state that: *"The misuse of financial instruments and of certain shareholding structures which may obstruct transparency, such as bearer shares […] should be prevented".* Many of our European and Commonwealth counterparts have already restricted the use of bearer shares, such as France, the Netherlands, Spain, Ireland, New Zealand and the Isle of Man.

31. Eliminating the anonymity and transferability of bearer shares should be considered in the context of a package of measures, including the implementation of a central registry of company beneficial ownership information. We have consulted on proposals to require information on individuals with an interest in more than 25% of a company's shares or voting rights, or who otherwise exercise control over the way a company is run, to be provided to a central registry – the continued existence of bearer shares would be conceptually inconsistent with that, and could offer a means of evading identification and sanction should those requirements not be met.

32. The problem of opaque company ownership structures can therefore be summarised as increasing the potential for criminal activity and potentially also reducing levels of trust in business. Without Government intervention, there is unlikely to be sufficient collective action by industry to address these issues; particularly given the criminal nature of the activity we are aiming to address.

C. Economic rationale for intervention

Rationale for intervention

33. There are two facets to the economic rationale for Government intervention through the policy changes described here. Firstly there is the **regulatory failure** associated with the current corporate governance and company law frameworks, which enable those that control companies to remain anonymous and hence allow or even facilitate financial crime. Secondly, and linked to that, there is an **information asymmetry** with respect to company ownership and control, between those that control companies and those that trade with them or invest in them, which inhibits economic activity. The inefficiency and reputational damage that crime introduces to the economy, as well as the lost business and reduced investment from information asymmetry, could all negatively impact on economic growth.

i. Regulatory failure and the potential facilitation of crime

34. There is a well-established role for the State addressing criminal behaviour. This includes the introduction of laws which form a central part of the UK's institutional infrastructure and business environment. By upholding the law and enforcing property rights, the State thereby facilitates economic activity. The State's role also includes the provision of criminal investigation and law enforcement, not least where there are externalities and the potential for free-riding. It could be argued that there is a regulatory failure where there is a deficiency in the legal framework, or in the functions of associated institutions, which facilitates crime (which in turn imposes costs on society). There is therefore a clear rationale for intervention where the net benefits of government action outweigh the cost of inaction.

35. Companies and other corporate entities have separate legal personality, meaning that they can enter into contracts and business relationships in their own name. Importantly in addition, many companies take advantage of the option to have limited liability for their investors. In exchange for these advantages, which facilitate entrepreneurship[241], a company is required to put additional information in the public domain (e.g. their accounts, and information on their shareholders and directors) compared to other business forms (e.g. sole traders). However there still remains scope for opacity around corporate ownership structures and company control. Various aspects of the current corporate ownership system (e.g. bearer shares, opacity of beneficial ownership, or opaque arrangements involving directors) can be used to conceal an individual's interest in a company from the authorities. This means that law enforcement agencies cannot readily identify individuals behind/controlling a company and, as a result, in some cases criminal activity can be facilitated.

36. The anonymity afforded by the corporate structure also means that the individuals who 'stand behind' the company can then use the company as a front to launder the proceeds of crime and to finance organised crime and terrorism[242]. In effect, the corporate structure can be used to help support criminal activity - from the supply of drugs, to fraud and corruption. This anonymity also means that law enforcement agencies cannot always readily identify the individuals really responsible for the criminal activity - resulting in less efficient and effective investigations; and potentially sub-optimal outcomes. Where the corporate governance and company law frameworks do not ensure sufficient transparency to prevent this opportunity, and hence also fail to reduce the need for risk mitigation measures by counterparties or inefficient corporate activity, it can be viewed as a **regulatory failure**.

37. Thus, in this case, regulatory failure facilitates crime which can lead to costs to the economy and more widely to society. These costs include the welfare damage to the victim; inefficient resource allocations and a forced redistribution of income; lost economic activity/output; inefficient insurance expenditure; and costs to the criminal justice system, including the police[243]. The aim of this policy to address the regulatory failure affecting the transparency of corporate ownership and control is to reduce the opportunity for criminal activity and thus reduce these costs to the UK.

38. Opaque corporate structures can not only facilitate crime but also hamper the law enforcement response. Firstly, during the investigation phase where time and resource can be used to

241 Entrepreneur Wealth and the Value of Limited Liability, Brian Brougham, 2011.

242 That is to say the money passing through the company can be of criminal origin, and / or can be used to support further crimes, and through the relative anonymity of the company structure the individuals involved can be concealed.

243 See Brand and Price (2000) "The economic and social costs of crime". Home Office Research Study 217. London: Home Office. and Dubourg et al (2005) "The economic and social costs of crime against individuals and households" 2003/04. Home Office Online Report 30/05. London: Home Office.

establish basic facts, such as who are the individuals owning particular assets or who controls a company, and secondly, during prosecution or after a conviction, by preventing confiscation of the proceeds of crime by the authorities and return of assets or compensation to the victims.

39. During policy development and consultation, law enforcement agencies have repeatedly set out the value of transparency; the SFO indicated that greater transparency over the beneficial ownership of UK companies would facilitate *'all, or almost all, SFO cases'*. At the early stages of any corporate case it is standard procedure for law enforcement agencies to gather relevant company data, including from Companies House. Requiring additional disclosure on company ownership and control was considered, in some cases, likely to provide *'powerful evidence'* and to create a *'deterrent effect to criminals'.*

40. Reducing opportunities for crime could help support conditions for growth. Each US$1bn laundered reduced overall economic growth by 0.04-0.06 percentage points in 17 OECD countries, prompting the UN to comment on the findings that *"financial centres have developed a self-interest of not being associated with 'tainted money' and have signed relevant international instruments to avoid the inflow of such criminal finance*[244]*."*

41. There is a strong body of evidence highlighting how crime acts as a drag on investment, job creation and ultimately economic growth. For instance, Goulas and Zervoyianni (2013)[245] find that in times of macroeconomic uncertainty, a 10% increase in the crime rate is associated with a reduction in annual GDP per capita growth of 0.49%-0.62%. Although these studies[246] do not directly identify the mechanism, they highlight that reducing crime will support growth.

ii. Imperfect/asymmetric information affecting the operation of the business environment

42. Opaque corporate ownership structures are also associated with **imperfect/asymmetric information**. In all economic transactions, one party to the transaction must acquire information about the other party to understand sufficiently the quality and risks associated with the goods, service or investment opportunity on offer. In particular, when engaging in high cost and long term economic relationships involving complex goods ("experience" or "credence" goods), services or investments (e.g. long term investment in corporations or purchasing high-end professional services), the information asymmetry between parties is likely to be large and significant.

43. The corporate form helps mitigate the impact of information asymmetry. This is because the company has separate legal personality: *"As a separate legal entity […] the company must be treated like any other independent person with rights and liabilities appropriate to itself*[247]*."* In other words, a person may engage with the company without needing to satisfy himself or herself of the nature of the persons *behind* the company - they simply need to be satisfied with the 'credentials' of the company itself, which is evidently a less onerous and more efficient process than needing to satisfy themselves with respect to all the individuals who might be associated with a company in various ways.

244 Estimating illicit financial flows resulting from drug trafficking and other transnational organized crimes: Research report. UNODC (October 2011).

245 Goulas and Zervoyianni (2013) 'Economic growth and crime: does uncertainty matter' Applied Economics Letters, Vol 20, issue 5, pp420-427

246 See also Detotto and Paulina (2013) 'Does more crime mean fewer jobs and less economic growth?' European Journal of Law and Economics, Vol 36, Issue 1, pp183-207 and Detotto and Otranto (2010) 'Does crime affect economic growth' International Review of Social Sciences, Vol 63, Issue 3, pp330-345.

247 Hannigan, B: Company Law (2003), Clays Ltd.

44. However, corporate opacity – created, for example, through the use of bearer shares which do not require an individual to be named in a company's register of members – can nevertheless lead to two sub-optimal outcomes.

45. The **first** is in terms of the ability of the members of the company to hold the directors to account. An individual holding 15% of the company's shares will not, on his own, be able to materially influence a key company vote. However, that individual can look to other members to support his position, thereby gaining a much greater ability to support or block the vote. This process is facilitated by the member's ability to access the company's register of members – this gives the means to identify to whom else they need to talk.

46. However, this register of members may not of itself be sufficient. For example, where bearer shares are issued, there will be no person named in the register of members. In these cases, an ability to identify the holder of the bearer share or the beneficial owner (i.e. the individual on whose behalf the shares are held) would improve the ability of the shareholders (understood here as the individuals and companies investing in the company, whether directly or through an intermediary) to hold the company to account, and ultimately drive more successful outcomes.

47. This enhanced transparency, enabling shareholders to hold companies to account, could be expected to have a positive impact on economic growth. As discussed in the Kay Review (2012)[248], greater shareholder unity enables shareholders to hold companies to account more effectively, which is thought to generate efficiency, corporate profit and therefore economic growth[249]. Essentially, by reducing the information asymmetry between the company board (agent) and the shareholders (principal), this enables the shareholders to more effectively align the board's incentives to generate positive outcomes from the company.

48. As noted in the seminal paper by Hirschman (1970), shareholders have two means to influence company boards; 'voice' (lobbying management and voting) and 'exit' (selling their shares). The additional transparency resulting from our package of policies gives shareholders more 'voice' to influence the board, hold it to account (particularly with respect to the company's ownership chain) and therefore drive corporate growth and long-term development.

49. The **second** is in terms of those who engage with a company wanting to know with whom they are actually dealing.

50. Despite the 'protection' that the corporate form affords in an economic sense; we might expect investors, suppliers and customers to want to know who actually owns and controls the company (again, its beneficial ownership) – not least as a means to mitigate reputational risk incurred as a result of transacting with a company subsequently found to have, for example, established links to terrorist groups or money launderers.

51. Knowledge of a company and its owners is therefore important in helping those who engage with a company to more accurately assess the risk of company transactions, and therefore their own engagement with them. Not knowing who ultimately owns/controls a company means that there is a greater inherent risk of making sub optimal investments, not being paid correctly for goods/services or inadvertently financing crime. This makes economic transactions/activities less attractive[250] and hence less likely to go ahead or they will go ahead but at a higher cost or lower

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[248] BIS (2012) 'The Kay Review Of UK Equity Markets And Long-Term Decision Making'.

[249] Bilych, G. (2012) 'Profit and economic growth' Macrothink Institute vol. 2 no. 2.

250Furthermore, considering adverse selection, if the share of 'bad' companies exceeds a certain threshold, the market will cease to exist as 'good' companies are driven out of business.

level. For instance, Easley and O'Hara (2004)[251] find that companies which keep a greater proportion of their information private require a greater compensating return for the lack of transparency, i.e. they face a higher cost of capital. This is a common finding in the economic literature[252].

52. Also when corporate information is not readily available, other parties must incur greater costs from conducting due diligence to mitigate this risk. They must, for instance, actively seek to determine the trustworthiness of the company and also write, complete and monitor contracts[253]. Therefore a lack of information will increase transaction costs, which can serve as a serious barrier to entry in the market, discouraging economic activity and harming growth.

53. Whilst both the higher cost of capital and greater risk mitigation represent a market response to a lack of information, they can also be inefficient. This raises the question of why all companies do not volunteer such information proactively. One possibility is that an individual's rationality is bounded[254] by the information they have, the finite amount of time at their disposal and limits to their ability to process and analyse all the information available. It is plausible that even though information about the business advantages of corporate transparency exists, companies may be unaware of it. Alternatively, the costs of identifying, accessing, understanding and applying this information (e.g. the opportunity cost of a director's time) outweigh the perceived benefits. Furthermore, evidence may be available only in an abstract sense, and not easily accessible to many companies. Therefore, many companies may not volunteer relevant corporate information in these circumstances.

54. Given that such bounded rationality is likely to be pervasive, firms behaving in this way (i.e. not revealing relevant corporate information) would not necessarily be forced out of the market by more competitive rivals in the long run, even if we assume that markets are competitive.

55. Opacity could also drive adverse selection[255]. The potential investor/ lender/ customer/ supplier of a company cannot distinguish between a low-risk transaction and a high-risk one because of asymmetric information around ownership and control. Therefore they offer 'average' terms and conditions for that transaction. This means that some mutually beneficial trades will only go ahead at a sub-optimal quantity, or not at all. Over time, standard economic theory suggests that fewer mutually beneficial trades will take place as fewer high quality offers are put to the market on the supply side and risk averse firms and investors start to opt out of the demand side. A market for 'lemons' is the result[256]. On this basis, a lack of transparency and trust can inhibit optimal economic activity.

56. Finally, there is a broader point around the role of trust in the smooth operation of the economy. The literature commonly identifies a significant and positive relationship between trust and overall

251 Easley, D. and O'Hara, M. (2004) 'Information and the Cost of Capital' The Journal of Finance, Vol. 59, No 4.
252 See Barry, C., and S. J. Brown (1985) "Differential Information and Security Market Equilibrium." Journal of Financial and Quantitative Analysis 20, no. 4: 407-22 for a model, which demonstrates that securities with relatively little information are of a higher systemic risk. See Merton, R. (1987) "A Simple Model of Capital Market Equilibrium with Incomplete Information." Journal of Finance 42, no. 3: 483-510. Finds that in a model where investors are not aware of all stocks available i.e. suffer from incomplete information, the equilibrium value of each company is always lower.
253 Nonetheless, knowledge is always imperfect to some extent: as noted by Miller and Whitford (2002)253 without all encompassing contracts, which account for every eventuality, some element of trust is implicit in every business contract.
254 Gigerenzer, Gerd and Selten, Reinhard (2002). Bounded Rationality. Cambridge: MIT Press.
255 It refers to a market process in which undesired results occur when buyers and sellers have access to different information; the "bad" products or services are more likely to be offered and selected.
256 Akerlof G.A. (1970) 'The Market for "Lemons": Quality Uncertainty and the Market Mechanism' The Quarterly Journal of Economics, Vol. 84, No. 3., pp. 488-500.

economic growth, which emerges because trust motivates innovation, investment and more entrepreneurship[257].

57. Having said that trust alone will not drive growth, but it feeds into the stability of economic systems which are key to economic activity. In terms of its relative importance, Whiteley (2000)[258] finds evidence suggesting that social capital, defined as the extent to which people are prepared to co-operate based on interpersonal trust, has a highly significant impact on growth, at least as strong as education or human capital. More broadly, enhancing trust will act to improve the prospects, reputation and stability of UK businesses and financial services.

58. Hence, overall, the policy proposals around increasing the transparency of corporate ownership and control have the potential to:

- reduce crime, by addressing a regulatory failure in the corporate governance and company law frameworks; and
- reduce the risks around economic activity and increase trust by reducing information asymmetry between those that trade with, or invest in, the company and those that control it.

D. Policy objectives

59. As set out above, bearer shares permit a level of opacity which is incompatible with international standards and stated UK Government commitments. Our chosen policy option will seek to implement fully those commitments. This will require primary legislation.

60. The chosen option should contribute to the two main objectives of the *Transparency and Trust* package, which are to:

- reduce crime, and
- improve the business environment so as to facilitate economic growth.

61. The objectives of our chosen policy option are:

- in conjunction with the wider *Transparency and Trust* measures, to improve our understanding of who really owns and controls UK companies and prevent the potential for their misuse; and
- to ensure that the UK fully meets Global Forum and FATF standards on bearer shares activity.

62. In meeting these objectives we will also consider how best we can:

- effectively eliminate the prospect of bearer shares being used for the purpose of tax evasion or other criminal activity;
- limit any negative impact on the competitiveness of the UK business environment; and
- minimise the potential for removing an individual's property rights; and ensure that sufficient transitional and communication methods arrangements are made.

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257 For instance, see Knack S, (2001) 'Trust, associational life, and economic performance', World Bank; Dincer and Uslaner (2010) 'Trust and Growth' ; Knack, Stephen and Paul Zak (2001) "Trust and Growth", Economic Journal, 111(470): 295-321 and Knack & Keefer (1997) ' Does Social Capital Have an Economic Payoff? A Cross-Country Investigation', The Quarterly Journal of Economics, Vol. 112, No. 4, pp. 1251-1288. Bjørnskov (2012) 'How Does Social Trust Affect Economic Growth?' Southern Economic Journal, Working Paper 06-2, shows that trust has a direct impact on schooling, which in turn feeds into the investment rate and ultimately economic growth.

258 Whiteley, P. (2000). "Economic Growth and Social Capital," Political Studies 48, 443-466.

E. Description of options considered

Three options are considered: maintaining the current situation (Option 0); abolishing bearer shares (Option 1: the recommended option); and a mandatory custodian arrangement (Option 2).

Option 0: Maintaining the current situation ('Do Nothing' option)

63. Maintaining the current situation would involve the continued use of bearer shares by UK companies. This would mean the continued risks of tax evasion and money laundering, and in practical terms, the continued failure to meet international standards. As described above, the method under current legislation for identifying bearer shareholders is not compliant with international standards on tax transparency and is deficient in terms of its powers to deliver, as well as being labour intensive and expensive.

64. One perceived benefit would be the maintenance of a means of preserving the anonymity of shareholders involved in legitimate but controversial activities, such as research using animals, where there were concerns about harassment and physical harm. As also previously discussed, 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. However, in such cases there will likely be other – lawful – ways to achieve the required degree of anonymity without the additional risks of the transferability and complete lack of paper trail for law enforcement agencies that bearer shares afford.

65. This is our least favoured option.

Option 1: Abolition of bearer shares (Recommended option)

66. This option includes:

- prohibiting the creation of new bearer shares to prevent the potential for misuse; and
- providing a set period of time for holders to surrender their existing bearer shares and convert these to the registered shares specified in the warrant.

67. This will be the most effective means of preventing the potential for misuse of bearer shares. We do not think that the potential use of bearer shares for lawful purposes outweighs the advantages of entirely preventing the potential for misuse.

68. This option draws on the experiences of other countries that have eliminated existing bearer shares in their jurisdictions. 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 registered shares, held electronically or otherwise.

69. We propose to adopt a similar model in the UK. This would mean that we would prohibit the issuance of new bearer shares from the date of commencement of the measures, and then provide a set period of time (anticipated to be around 12 to 15 months[259]) in which existing bearer shares could be converted to registered shares. We will develop processes for the conversion phase as we further develop the policy. The length of time allowed should be long enough to

[259] Analysis in this Impact Assessment is modelled on a period of 12 months.

enable bearer shareholders to convert their shares (particularly given that some will be holding them for entirely legitimate reasons) but not so long that it undermines the need for robust and rapid action.

70. Measures would need to be in place to deal with any bearer shares that remained unconverted at the end of the conversion period. We would anticipate requiring bearer share issuing companies to apply to the court for cancellation of any bearer shares that remain unconverted at the end of the conversion period.

71. If bearer shares are prohibited, some current users are likely to seek alternative legitimate means to maintain their anonymity, most notably using an intermediary to hold the legal title to the shares, collect the dividends and vote on their behalf. However from a policy perspective, we are satisfied that this meets our transparency standards. Use of intermediaries relative to bearer shares removes the infinite transferability and provides some paper trail for law enforcement. In addition, individuals with an interest in more than 25% interest of a company's shares or voting rights will be required to be disclosed on a register of beneficial ownership (and see related Impact Assessment in the *Transparency and Trust* package); limiting the scope for obfuscation. Moreover, in implementing our bearer shares policy, there could be scope for us to monitor the conversion of bearer shares and report any cases which we believe to be a deliberate measure to hide company ownership for nefarious purposes to law enforcement agencies.

72. Option 1 is our recommended option for the reasons (relating to promoting economic growth and reducing crime) set out in the next section on costs and benefits.

Option 2: Mandatory custodian arrangements

73. This option includes:

- ensuring existing bearer shares are held by a bank under a custodian arrangement; and
- potentially also prohibiting the creation of new bearer shares.

74. This option would mean that the identity of the bearer shareholder can be determined, therefore increasing transparency. This is one of the options given by FATF to meet its recommendation on bearer shares.

75. This practice could be modelled on American depository bank services using American Depository Receipts (ADRs). ADRs are issued by a US depository bank and can represent an individual's foreign shares. The depository bank holds this stock on their behalf and performs the role of registrar, transfer agent, record-keeper, dividend and paying agent, and co-ordinator of the proxy voting process. This information is then provided to the issuing company so that they may manage and verify the voting process. In effect, the depository bank works as an intermediary between the beneficiary and issuer. Using this model would mean that the bank would have to hold the physical bearer share in its own vault and in effect would hold legal title to the shares.

76. Measures would need to be in place to deal with any bearer shares that remained unregistered at the end of any transitional period. As under Option 1 we would anticipate requiring bearer share issuing companies to apply to the court for cancellation of any bearer shares that remain unregistered at the end of the conversion period.

Consideration of alternatives to regulation

77. We do not think that a non-regulatory approach would be sufficiently effective in meeting our policy objectives to reduce crime and improve the business environment so as to facilitate economic growth.

78. A non-regulatory approach may contribute towards the objective of promoting good corporate behaviour to a certain degree – and as more companies disclose this information; others should be incentivised to do likewise. However, we do not think that a voluntary campaign would be as effective as a mandatory approach to ensure that the benefits of enhanced corporate transparency are universally realised. In addition, where companies do not comply with a voluntary approach, it will remain difficult for those engaging with a company to identify who they are really doing business with.

79. In addition, we do not think a voluntary approach would effectively meet the objective of reducing opportunities for crime made possible by the current opacity of corporate ownership. There are non-regulatory techniques for crime prevention and reduction, as outlined in the Home Office's *Serious and Organised Crime Strategy*[260]. For example, education and communications strategies to raise awareness of the impacts of serious and organised crime.

80. However, a key element of the strategy relates to "*prosecuting and disrupting serious and organised crime"*. This necessitates a regulatory approach – regulatory requirements to make it more difficult for criminals to operate and regulatory sanctions to allow prosecution and disrupt criminal activity (e.g. by imprisoning offenders, thereby preventing further criminal activity). In the context of corporate transparency, law enforcement agencies have endorsed the importance of a regulatory approach - highlighting the potential to deter and disrupt criminal activity.

81. We therefore anticipate that a non-regulatory approach would not contribute to reduced levels of crime as companies engaged in criminal activity would simply opt not to disclose the required information. Although law enforcement agencies could continue to use existing mechanisms to identify the holders of bearer shares, a non-regulatory approach would likely not assist them in so doing. And even if enforcement agencies were provided with additional resource to carry out such investigations, this does not address the underlying problem of corporate opacity. A necessary corollary of a non-regulatory approach might therefore be a continued need for increased levels of public sector spending.

82. Finally, under a non-regulatory approach the UK would not meet its G8 commitments and would not be compliant with FATF or Global Forum standards, which may impact the UK's reputation as a clean and trusted place to do business and invest. Other jurisdictions may take no or similarly weak action in this area, which means that UK citizens and enforcement agencies will continue to be impacted by crime conducted by overseas companies in the UK.

F. Monetised and non-monetised costs and benefits of each option

83. In order to gather evidence of the impact of these proposals on UK businesses, individuals and the public sector, and to inform thinking around policy and implementation, BIS has undertaken a literature review, a call for evidence in a public discussion document, various focus groups, discussions with academics, a self-selection online survey, and a fuller survey using interviews (see **Annex A** for the methodology). The results from these are used to inform the analysis below and are based on the most robust and up to date analysis available. There remains, of course,

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[260] Home Office, October 2013: https://www.gov.uk/government/publications/serious-organised-crime-strategy.

scope for further development of the analysis, and we welcome reflections and contributions to the evidence base which help to expand on specific points or set out the wider picture.

Option 1: Abolition of bearer shares (recommended option)

Benefits

84. The increased corporate transparency arising from the abolition of bearer shares may lead to substantial economic benefits.

85. Benefits can be categorised into benefits to government and individuals arising from reduced criminal activity and benefits to businesses and individuals associated with increased economic activity arising from increased transparency.

B1. Benefits to government, individuals and business of a reduction in illicit activities

86. To identify the economic benefits arising from a reduction in illicit activity, we first quantify the total economic cost of illicit activity. The proposed policy to abolish bearer shares will help to prevent crime by removing a mechanism that could be used to facilitate crime and should result in a situation where apprehending criminals is both cheaper and easier for law enforcement agencies. Based on our understanding of the impact this policy will have on crime, we derive illustrative estimates of the benefits using a range of assumptions about the scale of the crime reduction.

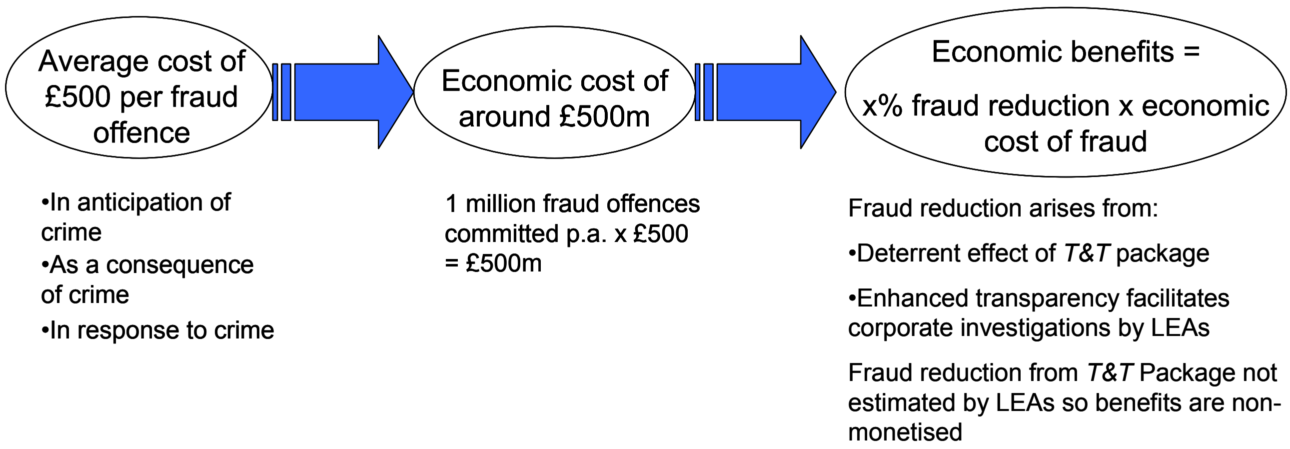

Figure 1: The logic chain behind the benefits of the Transparency and Trust package

87. Consultation with law enforcement agencies revealed strong support for action across the *Transparency and Trust* package including with respect to abolishing bearer shares due to the expected impact on criminal activity. They reported that corporate opacity was a feature of much of the criminal activity they were seeking to combat and reducing it would support a reduction in crime.

i. Total economic cost of fraud

88. On this basis, we have, as set out below, sought to partially monetise the benefits arising from reduced crime as a result of abolishing bearer shares. It is not possible to fully monetise the benefits to society from a reduction in crime, or the benefits to law enforcement agencies in terms

of reduced costs, in part because of the way in which law enforcement agencies record their case data. Given the huge scale of any corporate investigation and the corresponding myriad evidence, there is no systematic distillation of these data such that we can interrogate the impact of a single factor, such as the misuse of bearer shares. Indeed, a criminal could conceal his or her identity using a number of, and indeed multiple concurrent, approaches.

89. Although law enforcement agency data will not yield a robust estimate of a direct impact on the crime rate resulting from the abolition of bearer shares, the SFO has commented that the overall *Transparency and Trust* package would 'make UK corporate vehicles less attractive to criminals as means to commit fraud or facilitate money laundering'. The NCA 'support[ed] the proposals in the *Transparency & Trust* [discussion] paper.' Other law enforcement agencies and HMRC have also contributed to our discussions and were similarly supportive of the *Transparency and Trust* package as likely to deliver benefits in terms of combating criminal activity.

90. The crime associated with lack of transparency of company control, including through misuse of bearer shares, imposes significant direct costs on society. These costs include the physical, financial and emotional damage to the victim[261]; insurance expenditure; lost output; and costs to the Criminal Justice System, including the police. The economic cost of crime for a full range of offence categories has been estimated by Brand and Price (2000)[262]. We have selected fraud as a key crime on which to focus here; it is a financial crime of the sort that could be facilitated by the use of opaque company ownership structures and Brand and Price's fraud data also encompass money laundering. In pulling out this strand for further analysis, we should bear in mind the breadth of potential criminal activity linked with opaque corporate structures.

91. Below, we estimate the total economic cost of fraud. This figure is then used to give illustrative examples of the potential economic benefits resulting from the crime reduction associated with this policy. Given that law enforcement agencies cannot identify the crime reduction caused by individual policy changes, we have offered illustrative examples to go some way towards estimating the benefits.

92. The estimates Brand and Price use are in turn based on a study by National Economic Research Associates (NERA; 2000). The methodology places a value on the opportunity cost of resources used:

- in anticipation of crime (e.g. insurance[263] or security expenditure),
- as a consequence of crime (e.g. to the victim); and
- as a response to crime (e.g. to the criminal justice system[264]).

93. We have uprated the average cost estimates for inflation to arrive at estimates in 2013 prices, according to standard HMT GDP deflators[265], and removed the cost of benefit fraud which as a

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261 Economic theory would normally dictate that theft, for instance, is a transfer from one individual to another, so is not considered a loss to society. However, given that the transfer is unwanted and moves the stolen item from the legal economy to the illegal economy, following Brand and Price (2000), we consider this part of the costs of crime.

262 Brand and Price, (2000) "The economic and social costs of crime". Home Office Research Study 217. London: Home Office. Although this is not a recent publication it set the standard for robust analysis in this area, and as set out below prices have been adjusted for 2013.

263 In a purely economic sense, when an insurance claim is made, it is a transfer. As such 'insurance expenditure' in our estimates only includes insurance administration costs (i.e. the running costs for insurance companies – staff, ICT, property etc) because without crime these costs would be deployed elsewhere in the economy (See Brand and Price (2000) for more detail). Companies might, for instance, purchase fidelity guarantee insurance to protect against fraud by an employee, or crime protection insurance. The Fraud Advisory Panel currently advise small businesses to consider such products, as part of their advice to reduce the impact of fraud on small and medium sized businesses. "Fraud Facts" 2009 https://www.fraudadvisorypanel.org/pdf_show_112.pdf.

264 The estimated impact on the Criminal Justice System (CJS) is based on the Home Office 'flow and costs model'. The model estimates the long run costs of a criminal flowing through the system from prosecution and trial to probation or imprisonment. This is based on an active sample of resource costs from staff in the CJS and any associated agencies.

conservative step could be considered a subset of fraud less likely to be related to misuse of company structures. This gives us two estimates of the cost per fraud offence of approximately **≈£500** and **≈£1400** in 2013 prices as shown in Table 1.

		1999 Cost (£m)	2013 Cost (£m)
Resource Costs	Criminal Justice System (incl. SFO)	579	733
	Other public sector	412	522
	Private sector	156	198
Transfer Costs	Public sector	2682	3396
	Private sector	1377	1743
	SFO	1138	1440
Other Misallocation of Resources (Tax Distortion)		1858	2352
Number of Offences		7.7m	7.7m
Total Economic Cost (Excluding Transfers, £m)		3006	3805
Average Cost Per Offence (Excluding Transfers, £)		≈400	≈500
Total Economic Cost (Including Transfers, £m)		8202	10384
Average Cost Per Offence (Including Transfers, £)		≈1100	≈1400

Table 1: The economic cost of fraud – a report from the Home Office and Serious Fraud Office (NERA, 2000)

**Average costs have been rounded to the nearest £100 but the original values are used in calculations.*

94. The two estimates differ because the lower figure of **≈£500** excludes transfer costs. A transfer is a redistribution of a good or income from one party to another party such that the recipient's gain exactly offsets the donor's loss and no resources are used. In a pure economic sense, when a criminal steals a victim's property this is a transfer. In reality, however, it is an unwanted transfer, and victims suffer the emotional and physical impact of crime; indeed, the Ministry of Justice 'Criminal Justice System Cost-Benefit Framework' considers the victim's losses but not the offender's gains from crime. Including transfer costs gives a figure of **≈£1400** per fraud offence.

95. We consider **≈£500** as our 'best,' and most parsimonious estimate, while providing the estimate of **≈£1400** for further context as the cost of a fraud offence. While we cannot directly relate a number or proportion of such offences directly to the use of bearer shares we can estimate, for illustrative purposes, the overall economic cost of fraud, and seek to understand how it might be changed.

96. To arrive at an estimate, we multiplied the average cost of fraud offences by ONS (2013)[266] crime figures. We estimate that there were **1 million fraud offences** across the UK in 2012/13267. On the basis of 1 million fraud offences being committed in 2012/13 with an

265 https://www.gov.uk/government/publications/gdp-deflators-at-market-prices-and-money-gdp-march-2013.
266 Office for National Statistics (2013) 'Crime in England and Wales, year ending June 2013 – Appendix tables'.
267 Since the ONS data are only for offences committed in England and Wales and the NERA figures cited in Brand and Price (2000) split all UK recorded offences into those committed in each devolved administration, we applied the same proportional distribution as Brand and Price

average cost of **≈£500**[268] we estimate that the total economic cost is **£523m**, of which **£496m** falls on the public sector[269] and **£27m** falls on the private sector. This is calculated as follows:

- ≈£500 x £1m = £523m[270]
- Average cost per offence x number of offences

ii. The impact of this policy intervention

97. One might expect that the impact of the *Transparency and Trust* package, which contains a series of targeted measures, including abolishing bearer shares, would impart a deterrent effect on criminal activity. This could potentially be reinforced by any further deterrent effect from additional law enforcement capacity on the basis of greater investigation efficiency if companies are more transparent. This deterrent effect could in turn reduce costs for law enforcement agencies.

98. In terms of wider reductions in costs for law enforcement agencies, abolishing bearer shares would remove a layer of complexity in investigations seeking to identify the natural person controlling a company, resulting in expedited and more efficient processes.

99. Work with law enforcement agencies and wider consultation on the proposals robustly confirms that abolishing bearer shares would benefit the process of investigating cases. However, there is no reliable or systematic way of attributing reductions in law enforcement agencies' costs or the consequences directly and exclusively to abolishing bearer shares and for this reason, the benefits resulting from reduced costs to law enforcement remain non-monetised. We should also note that action on bearer shares forms only one part of the *Transparency and Trust* package. While it is difficult to reliably predict change in the crime rate related to any one part of the package, we could consider that the overall combined effect, including the deterrent effect, of implementing the comprehensive package, is likely to be greater than the sum of its parts.

iii. The scale of the economic benefits

100. As noted above, law enforcement agencies are not in a position to quantify the direct or deterrent benefits that the *Transparency and Trust* package might have on fraud offences. However, we can offer some illustrative examples of the likely economic benefits associated with reducing crime:

- If the package resulted in a 2% reduction in crime, it would yield economic benefits of £10.5m (2% of £523m).
- If the package resulted in a 5% reduction in crime, it would yield economic benefits of £26.1m (5% of £523m).
- If the package resulted in a 10% reduction in crime, it would yield economic benefits of 52.3m (10% of £523m).

101. For further context, as mentioned, we can use the average cost estimate of **≈£1400**, which includes transfers, to give an overall cost of fraud. On this basis, the total cost estimate

(91% of fraud offences committed in England and Wales; 8% committed in Scotland; and 1% committed in Northern Ireland) to arrive at an estimate of the total offences committed in the UK. This overall figure of 1 million excludes cheque and credit card fraud and accounts for the number of unreported offences, using the crime multiplier in NERA (2000).

268 To note unit costs are rounded for presentation in the text, with original figures used for calculation to give overall estimates.

269 Public sector costs include costs to the Criminal Justice System, the NHS, Customs & Excise & VAT, Inland Revenue and Local Authorities. The public:private sector cost distribution is calculated based on the distribution in the above table.

270 To note unit costs are rounded for presentation in the text, with original figures used for calculation to give overall estimates.

rises to approximately **£1.43bn**. Of this figure, around **£1.16bn** falls on the public sector and **£270m** falls on the private sector. The economic benefit of reducing corporate opacity to reduce this crime would similarly be derived from the reduction in these indicative costs.

102. Of course, feeding in to or stemming from illicit activity associated with companies are a range of organised crime and potentially terrorism offences, which would encompass more offences than fraud alone. As noted in Brand and Price (2000), the crime multiplier associated with organised crime is substantial because it sustains and creates other criminal markets, which impose further costs on society. The recent Home Office analysis which accompanied the launch of the National Crime Agency (Mills et al 2013) highlights that organised crime cost the UK £24bn in 2010/11, with drugs supply, for instance, costing the UK £10.9bn within that total[271]. The Home Office analysis excludes money laundering, which as mentioned above has a significant global impact.

103. The economic benefit of reducing corporate opacity could therefore reduce the costs arising from a wide range of criminal activity, and as noted above the impact of the package could be greater than the sum of its parts.

104. The above analysis represents just one potential source of benefits of reducing crime. Subjective wellbeing benefits should also be considered. As Brand and Price (2000) set out, there are a range of potential emotional and physical impacts on victims of crime, which might leave a legacy of problems. Reducing crime based on corporate opacity, including through abolition of bearer shares, will therefore realise benefits to national well-being, as measured by the National Well-being programme led by ONS[272].

105. Action will also help to develop an environment conducive to economic growth in the UK, and attendant benefits. There is a strong body of evidence highlighting how crime in itself acts as a drag on investment, job creation and ultimately economic growth. For instance, Goulas and Zervoyianni (2013)[273] found that in times of macroeconomic uncertainty, a 10% increase in the crime rate is associated with a reduction in annual GDP per capita growth of 0.49%-0.62%. Although the literature[274] does not directly identify the mechanism through which crime affects growth, it has repeatedly been highlighted that reducing crime will support growth.

106. There are also benefits to reducing crime which accrue not just in the UK but internationally. These are not within scope of the process of assessing the impact of the policy change for these purposes, but are nevertheless important. As various reports set out, illicit flows out of low income countries, particularly in Africa, will often be channelled through company structures. They are extremely significant, and it is often noted that these countries lose billions of dollars per year in illicit financial flows. Though almost by definition figures are difficult to derive, the Africa Progress Panel chaired by Kofi Annan[275] highlighted the problem, citing research suggesting that the annual loss to Africa between 2008 and 2010 was $38bn, and that between 1970 and 2008 $1.8 trillion were lost from the continent - with obvious human

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271 Home Office analysis cost estimates presented do not include SOCA costs of preventing and responding to organised crime (Mills et al 2013, Understanding organised crime: estimating the scale and the social and economic costs, Home Office, Research Report 73) https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/246390/horr73.pdf.

272 http://www.ons.gov.uk/ons/guide-method/user-guidance/well-being/index.html. This includes measures of the crime rate, happiness, anxiety and mental well-being.

273 Goulas and Zervoyianni (2013) 'Economic growth and crime: does uncertainty matter' Applied Economics Letters, Vol 20, issue 5, pp420-427.

274 See also Detotto and Paulina (2013) 'Does more crime mean fewer jobs and less economic growth?' European Journal of Law and Economics, Vol 36, Issue 1, pp183-207 and Detotto and Otranto (2010) 'Does crime affect economic growth' International Review of Social Sciences, Vol 63, Issue 3, pp330-345.

275 'Africa Progress Report 2013: Equity in Extractives' Africa Progress Panel (2013).

consequences[276]. Moreover, as the National Organised Crime Strategy (2013) sets out, "overseas, organised crime undermines good governance and the stability of countries of strategic importance to our national security. Organised crime groups overseas can facilitate or engage in terrorism." Reducing the potential for abuse of the company structure should therefore derive benefits not only for crime in the UK, but for the UK's international reputation and for its international partners, particularly low income countries.

B2. Improving the business environment: benefits to companies and individuals from corporate transparency supporting the business environment

107. Abolition of bearer shares will reduce the opacity of those companies which currently use this type of equity instrument (or would have done so in the future); it will become easier for external parties to determine the ownership and control of a company. The policy change and communication of it will also have broader impacts on the business environment in the UK.

108. Economic theory suggests that an increase in transparency; for instance through abolishing bearer shares, is likely to reduce information asymmetry and increase trust and therefore increase economic activity including trade and investment (see 'Rationale for Intervention' section). Empirical evidence in this area, whilst informative, relates to a general relationship, rather than bearer shares specifically.

109. Ultimately, enhancing trust in the business environment serves to "grease the wheels" of economic activity and facilitate economic growth. Greater transparency is associated in the literature with greater investor confidence, alongside trust in companies and between companies. This enables economic transactions to go ahead more readily, since, for instance, a buyer will not be discouraged or delayed by a lack of transparency and trust in a seller, which enables them to safely simplify the contracting process between them[277]. Therefore increased corporate transparency can increase economic growth through the mechanism of increasing trust and reducing transaction costs.

110. A theoretical framework connecting transaction costs with trust was set out by Bromiley and Cummings (1995) who described a typical agency problem, between a shareholder (principal) who depends on the actions of the company board (agent). They explained, drawing on earlier findings, how a lack of trust can feed into higher transaction costs[278]. This agency problem and the associated complexity related to trust can impact on transaction costs in other settings. Empirically this has received support from Dyer and Chu (2003)[279] who investigated the relationship between 344 buyers and suppliers in the automotive industry of the US, Japan and Korea. Dyer and Cho concluded that transaction costs[280] were five times higher for the least trusted supplier.

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276 'Illicit Financial Flows from Africa: Hidden Resources for Development' Global Financial Integrity and the African Development Bank (2013).

277 The importance of trust in economic transactions is highlighted in Fukuyama, F. (1996) 'Trust the social virtues and the creation of property'

278 Bromiley, P. & Cummings, L.L. (1995) 'Transactions costs in organizations with trust' Research on Negotiations in Organizations, Vol. 5: 219–47, set up the theoretical framework, which connected transaction costs with trust. This was based on the findings of Williamson O.E. (1985) 'The Economic Institutions of Capitalism' which formally founded the New Institutional school of economics. However, the literature is somewhat ambiguous as to the strength of the link between trust and transaction costs.

279 Dyer J.H. and Chu W. (2003) 'The role of trustworthiness in reducing transaction costs and improving performance' Organisation Science, vol. 14 no 1, pp57-68.

280 North, D.C. (1990) 'Institutions, institutional change and economic performance', defines transaction costs as 'the cost of measuring the valuable attributes of what is being exchanged and the costs of protecting rights and policing and enforcing agreements.' Transaction costs come in the form of searching for a contract and relevant information; bargaining and decision making relating to that contract; and policing and enforcing the contract.

111. There is also a known link between overall economic growth and trust[281], with the literature commonly identifying a significant positive relationship between the two. This emerges because trust motivates investment, innovation and more broadly entrepreneurship[282]. To test the hypothesis that trust reduces transaction costs and therefore enhances growth at a national level, the empirical literature commonly analyses cross-country samples to assess how far countries with higher levels of trust have a higher rate of economic growth. Knack and Keefer (1996)[283] initiated this strand of the literature, finding that a 10 percentage point increase in trust, as measured by the World Values Survey (WVS), is associated with a 0.8 percentage point increase in growth. Zak and Knack (2001)[284] later extended this analysis by adding 12 countries to the dataset - again the relationship between trust and economic growth was significant and positive and a 10 percentage point increase in trust was associated with a 0.7 percentage point increase in growth.

112. The literature has built upon the two seminal papers by Knack and Keefer (1996) and Zak and Knack (2001) by testing their robustness and re-analysing the data. Beugelsdijk et al (2004)[285] find that the Zak and Knack (2001) study had highly robust trust coefficients in terms of significance and magnitude. However, they argued that the relative importance of trust in the study is somewhat affected by which countries are included in the sample and the factors for which the regression controls. More recently Horváth (2013)[286], however, found interpersonal trust to be a 'robust determinant of long-term economic development,' in a study of 50 countries. Indeed, Horváth disagreed with the findings of Beugelsdijk et al (2004) that the link between trust and growth is sensitive to the factors included in the model.

113. Analysis of US states by Dincer and Uslaner (2010)[287] found a similar (though slightly weaker) relationship between trust and growth – a 10 percentage point increase in trust being associated with a 0.5 percentage point increase in the growth rate. This highlights that the relationship still exists in developed countries or jurisdictions where the rule of law is well established (where one might otherwise have expected it to be restricted to jurisdictions with weaker institutional infrastructure and greater reliance on knowing and trusting business partners).

114. The relationship between growth and trust is therefore a developing strand in the literature and there are some continuing points of debate around the data used. The empirical studies are often reliant on the World Values Survey (WVS), which asks the general question 'do you think people can be trusted?'. Comparing responses over time, as Beugelsdijk (2006)[288] comments, might indicate more of a change in a population's honesty, attitudes or information rather than their behaviour. However, there are few alternative international measures for trust, which in itself is challenging to measure.

115. The literature does not generally analyse the mechanisms through which trust affects growth. As noted by Dincer and Uslaner (2010), one might expect trust to affect growth via the

281 The literature commonly considers trust in a general sense rather than specifically looking at trust in the business environment. A frequently used source is the World Values Survey (WVS). This is a cross-country social survey of beliefs and values, which asks 'do you think people can generally be trusted'. Although the WVS is not directly related to the level of trust in the business environment, as noted by Beugelsdijk (2006) it is strongly correlated with the effectiveness of institutions, which includes industry/business as an institution. We can therefore expect trust to be a good proxy more specifically for trust in the business environment.

282 However, the literature must carefully control for reverse causality, i.e. how far high growth countries are generally more trusting.

283 Knack, Stephen and Philip Keefer, (1996), "Does social capital have an economic payoff?: A cross-country investigation," The Quarterly Journal of Economics, 112(4), pp. 1251.

284 Zak, P.J. and Knack, S. (2001). 'Trust and growth', Economic Journal, 111, 295–321.

285 Beugelsdijk, S. de Groot, H.L.F. & van Schaik, A, (2002) "Trust and Economic Growth: A robustness analysis," Oxford Economic Papers 56 (2004), 118–134.

286 Horváth, R., 2013. "Does trust promote growth?," Journal of Comparative Economics, Elsevier, vol. 41(3), pages 777-788.

287 Dincer and Uslaner (2010) 'Trust and Growth' Public Choice (2010) 142: 59–67.

288 Beugelsdijk, S. (2006) 'A note on the theory and measurement of trust in explaining differences in economic growth' Cambridge Journal of Economics, 30, 371–387.

main growth drivers. To elaborate, that can envisage individuals in countries with low levels of trust might be more hesitant in engaging in entrepreneurial activity, for fear of protecting their contractual rights; and a lack of innovation and/or investment will certainly impede growth.

116. Two notable exceptions are Bjørnskov (2012)[289] and Botazzi et al (2010)[290], which both examine mechanisms through which trust influences growth. Using cross-country data, Bjørnskov (2012) shows that a lack of trust limits the level of schooling, which in turn limits the investment rate and ultimately economic growth. Botazzi et al (2010) identify the strength of the relationship between trust and investment decisions in European venture capital markets. The theoretical mechanism identified by Botazzi is also similar to that found by Guiso et al (2008)[291], who look at stock market participation. Essentially, trust has an impact on an investor's perception of brokers and intermediaries, and a lack of trust thereby raises transaction costs and reduces the investment rate.

117. In and of itself, trust is not likely to drive growth, but it certainly feeds into stability and certain economic systems which are key to economic activity. In terms of its relative importance as a factor underpinning growth, Whiteley (2000)[292] found evidence suggesting that social capital, defined as the extent to which people are prepared to co-operate based on interpersonal trust, has a significant impact on growth, at least as strong as education or human capital.

118. By increasing corporate transparency, including through the abolition of bearer shares, benefits to trust, and therefore the business environment and potentially economic growth, should be realised.

Costs

Companies in scope

119. Companies House analysis indicates that 1233 UK companies have issued bearer shares, of which around 787 are still trading, the remainder being dormant. We assume for the purpose of this reform that both active and dormant companies would incur the same level of cost[293].

C1. Cost to individuals/businesses who currently own bearer shares: anonymity and transferability costs

120. The anonymity afforded by bearer shares is likely to be perceived as an advantage for those who hold them, which will include those who wish to conceal their identity for criminal purposes, but could also include those who are vulnerable in some way, including those who wish to invest in legitimate but controversial sectors such as life sciences, or wealthy individuals who fear targeting by fraudsters. Using Companies House data, we sent out a letter to all 1233 UK bearer share issuing companies. We had 468 total respondents, 467 of which are from bearer share-issuing companies. 6 of these respondents stated they were against and 8 stated they were in favour of prohibition. The rest reserved opinion. 65% of respondents (306 out of 468) to our letter to bearer share issuers identified the potential impact on vulnerable shareholders. There could be costs falling to these people from the additional steps they choose to take to organise their new shareholdings, not in bearer form. There is a lack of evidence in the

289 Bjørnskov (2012) 'How Does Social Trust Affect Economic Growth?' Southern Economic Journal, Working Paper 06-2.
290 Botazzi, L., Da Rin, M. and Hellman, T. (2010) 'The importance of trust for investment' NBER Working Papers 16923.
291 Guiso, L, Sapienza, P. and Zingales, L. (2008) 'Trusting the Stock Market' The Journal of Finance, Vol 63, Issue 6, pp2557- 2600.
292 Whiteley, P. (2000). "Economic Growth and Social Capital," Political Studies 48, 443-466.

293 Please note: costs have been rounded in this section to avoid spurious accuracy.

literature about the economic benefits from anonymity. Therefore it is not possible to fully quantify this cost.

121. The anonymity of bearer share ownership can also be used to maintain competitiveness in the market; two respondents to our letter highlighted this. Their companies specifically issue bearer shares to allow investors who invest in competitor businesses to invest in their business without affecting their credibility. Theoretically companies might also seek to invest in competitors anonymously in the context of mergers and acquisitions, but our consultation did not yield any evidence to relate this to bearer shares. Overall, the costs in this space seem unlikely to be significant.

122. The transferability of bearer shares, while a money laundering risk, makes them an attractively liquid asset. Abolishing bearer shares, and conversion of holdings into registered shares, will result in a loss of this transferability which presumably has an economic value.

123. Ideally we would wish to estimate the following economic relationship: (Number of bearer shareholders) * (unit benefit per bearer shareholder from anonymity and transferability). In order to generate an estimate, we have pursued the following approach

124. To estimate the number of bearer shareholders we have multiplied the number of UK companies who have issued bearer shares (1233) by an estimate of the average number of total shareholders per UK company (2.3) based on a weighted average of a distribution provided by Companies House[294]. This calculation is based on the assumption that the number of shareholders per company for all types of shares is the same as for bearer shares.

125. This gives an estimated number of bearer shareholders of 2836 (1233*2.3), which given the general sense of the figure we have taken to one significant figure and will use 3000 for the following calculations.

126. To calculate transferability costs we first need to estimate the average cost of converting a share. Share conversion for private companies' shares involves processing a simple two page Stock Transfer proforma[295] and posting it to the Stamp Office. This will have a time cost in terms of the time taken to post and fill in this form. For these purposes, in the absence of more information we assume that a shareholder earns the mid point between our low estimate of the median wage (£13 per hour) and our high estimate of the median wage of a 'Corporate Manager or Director' (£24 per hour). This gives a cost of £19[296] per hour (2013 prices), internal modelling suggests that it would take 30 minutes to complete this form and post it. Multiplying £19*0.5 hours gives a cost per transaction of £9.50. This transaction also involves the payment of Stamp Duty. However this is excluded from the analysis as it is a transfer.

127. We then need to multiply this figure by the average number of transactions. Evidence suggests that the average private equity investment is held for 4.8 years, implying an average of 0.21 transactions per year[297]. Assuming that bearer shares are held for the same length of time as other private equity investments (bearer shares might in reality be held for longer than this but in the absence of more detailed evidence we use the average figure) then implies a total average ongoing cost of 3000*£9.50*0.21 = **£6k**.

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[294] Internal Companies House data.

[295] http://www.sse.com/uploadedFiles/Controls/Lists/Investors/Shareholder_forms/StockTransferFormApril_2012.pdf.

296 ASHE date 2012.

[297] PitchBook & Grant Thornton Private Equity Exits Report 2012 Annual Edition.

128. Some former bearer shareholders would choose to convert to cash instead of registered shares. These individuals would not incur transferability costs due to fact that cash is even more liquid than bearer shares. However they would incur the opportunity cost of the lost benefits of share ownership (capital gains etc). Economic theory regarding rational behaviour and revealed preference suggest that these benefits of bearer share ownership would be of at least equal value to the benefit of the greater liquidity of cash across the population of bearer shareholders. Otherwise bearer shareholders would not have purchased bearer shares in the first place. However, we will test this assumption for the next iteration of the Impact Assessment.

C2. Cost to individuals/businesses who own bearer shares: familiarisation, administration and time costs

129. For those who hold bearer shares, there will be familiarisation costs, plus administration costs and time costs associated with converting shares during the conversion period.

130. The bearer shareholders will need to familiarise themselves with the new rules and identify themselves and present their share warrant to the issuing company. After the share warrant's authenticity is verified, and the holder has proven their identity, they will be able to become a registered shareholder or can negotiate with the company to receive the appropriate reimbursement for sale of their shares.

131. Ideally, we would want to understand the following economic relationships:

i. Familiarisation costs

132. (Number of bearer shareholders) * (unit familiarisation costs)

ii. Administration and time costs

133. (Number of bearer shareholders) * unit time cost + unit monetary cost associated with exchanging bearer shares). In order to generate an estimate, we have pursued the following approach.

134. There would be a transition cost to all bearer shareholders in familiarising themselves with the requirements of the policy change to abolish bearer shares. Estimates above indicate that there may be 3000 bearer shareholders.

135. In order to understand potential familiarisation costs we use data from the *Transparency and Trust* Survey. It was not feasible to specifically survey owners of bearer shares. On the one hand it is not possible to identify individuals who own bearer shares because of their anonymous nature. Therefore it is not possible to target these individuals in a survey. On the other hand, due to the relatively likely number of bearer shareholders in the population, it is highly unlikely that we would discover a sufficient amount of bearer shareholders by chance to construct a reasonable sample for a feasible cost. For instance, we estimate that there are 3000 bearer shareholders of UK companies. Given that there are approximately 3.19m UK companies, and assuming that a bearer share issuing company is proportionately as likely to be sampled and respond, then there is likely to be a less than 0.1% chance (3000/3,190,000) of a bearer share owner being included in the sample. Therefore to sample 100 companies we would sample around 100,000 companies. This would make a survey disproportionate in terms of costs.

136. Therefore, in the absence of alternative information we used the cost of familiarisation with the Corporate Directors *Transparency and Trust* measure as a proxy. The weighted mean costs per company are £96. If we apply this to the estimated 3000 bearer share owners then this gives us an estimated transition cost of **£288k** (3000 * 96).

137. This appears to be a reasonable proxy because both measures involve the abolition of a specific and rather specialised corporate function which was previously permitted and therefore should have a broadly similar informational content. We also assume that a bearer share owner has approximately the same opportunity cost in terms of familiarisation time as the average UK registered company. We do have reservations about some of the data in the survey (see Annex A). However we are conducting further work to address this.

138. Further steps the bearer shareholders need to take will include identifying themselves to the company. At the time of writing, the proposed approach has not been established. However the market price for the standard Post Office procedure for verifying identity can be used as a proxy for this cost. The Post Office state a charge £7.50 for identity verification (2013 prices)[298], and provide an estimated duration of 20 minutes[299]. Assuming (in the absence of other available information) a time cost of £19[300] per hour (see C1), the opportunity cost of 20 minutes time would be £6 (0.333 hours* £19). This gives a total cost per shareholder (monetary and time cost) of £13.50 (£7.50 +£6). There should not be further related costs to add to this, since there is not generally a cost associated with opening a share account[301] in which to deposit ordinary shares. Therefore, if we multiply the £13.50 figure by 3000 owners of bearer shares, this implies a total estimated transition cost, due to time and administration, of **£41k** (3000*£13.50). This assumes that it would not take additional time to, for example, locate the share certificate.

139. Taken together, we can estimate transition costs arising from familiarisation and administration for bearer shareholders to be **£329k** (£288k+£41k).

C3. Cost to companies who issue bearer shares: financing costs

140. For companies who issue bearer shares, their abolition could increase financing costs. Firms may sell equity in bearer form to specifically targeted individuals or companies who place a particular economic value on anonymity and/or transferability. If they are not able to issue bearer shares and therefore cannot target this group for equity sales, then this could prevent companies from raising capital or mean that they are only able to sell their equity at a discount.

141. Ideally we would like to undertake the following calculation, but since there is limited evidence of financing costs in the literature it is not possible to quantify these ongoing costs.

142. (Number of bearer share holding companies) * (unit benefit of attracting individuals who value anonymity and transferability)

C4. Cost to companies who issue bearer shares: familiarisation, administration and search costs

143. Alongside those who hold bearer shares, there are also likely to be familiarisation, administration and time costs to issuers of bearer shares.

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298 http://www.postoffice.co.uk/document-certification-service.
299 BIS telephone interview with Post Office 2013.
300 ASHE date 2012.
301 http://www.money.co.uk/share-dealing.htm.

144. Firstly, this will include the familiarisation costs associated with issuing companies understanding the changes. Secondly, since holders of bearer shares will be required to approach issuing companies requesting that they either cancel and re-issue as registered shares or sell the shares; this will lead to administration costs to issuing companies. Thirdly, there will be a search cost (relating to the opportunity cost of time) associated with locating owners of bearer shares. Many issuing companies stated in response to the consultation that they register the details of their bearer shareholders, therefore reducing search costs, but some might not.

145. Ideally we would wish to understand the following economic relationship:

146. (Number of bearer shareholders) * (unit familiarisation cost + unit administration costs + unit search costs)

147. In order to generate an estimate, we have pursued the following approach.

148. As mentioned above, we work on the basis that there are 1223 companies that have issued bearer shares, we assume that there are 3000 bearer shareholders, and, in accordance with standard better regulation guidance, that there is 100% compliance with the legislation.

149. In terms of familiarisation costs, there would be a cost to all bearer share issuing companies in understanding the requirements around bearer shares. In total, 1233 companies have issued bearer shares. Responses to the *Transparency and Trust* discussion paper[302] indicate that at least 37% of those 1233 companies have their administrative affairs managed by two single agencies. Therefore, if we calculate 63% of 1233 ((1233*0.63)+2) and add on the two agencies then this gives 779 companies who will need to familiarise themselves with the policy change (assuming there are no other agencies covering multiple companies, which would reduce this number further). We assume that unit familiarisation costs are equal to the familiarisation costs identified above (i.e. £96), which gives a total transitional familiarisation cost of **£75k** (779*96).

150. There would also be administration costs to a bearer share issuing company, in terms of selling or converting the shares from bearer shares to the registered shares specified in the share warrants. Market data from Companylawsolutions.co.uk.com[303] (2013 prices) indicates that buyback costs £360 including VAT whist conversion to ordinary shares cost £200 including VAT. Given that we do not have information on the distribution of which option will be taken (buyback or conversion) we take the midpoint between the two processes of £280. If we multiply this midpoint by the estimated number of bearer shareholders 3000, then this gives a transition cost of **£840k** (3000*£280).

151. The search costs for a company to seek to identify its bearer shareholders are not readily quantifiable, but would derive from the need to make a ‘reasonable attempt’ to find the shareholder. We considered using information from the *Transparency and Trust* Survey as a proxy but there was not an appropriate analogy to draw upon.

C5. Costs to government

152. There will be a cost involved in communicating the abolition of bearer shares to bearer share issuing companies. We would plan to write to bearer share issuing companies

[302] *Transparency and Trust* Consultation, 2013.
[303] http://www.companylawsolutions.co.uk/prices.shtml.

communicating the change in policy. Since we wrote to all bearer share issuing companies as part of the consultation, we can define this transitional cost as **£840** (2013 prices), disaggregated into £83 for one day of staff time plus £35 for envelopes plus £720 postage costs[304]. The Government would focus communications on companies, who are accessible and identifiable, and seek to avoid any additional costs in terms of searching and communicating with bearer shareholders[305].

153. There would also be transitional development costs to Companies House of **£39k**[306]. This would arise from implementing validation rules to prevent companies from being incorporated which show 'bearer shares' and to monitor those which continue to show bearer shares via annual returns.

Option 2: Mandatory custodian arrangements

Benefits

B1. Benefits to government, individuals and business of a reduction in illicit activities

154. As with the abolition of bearer shares, a policy change through which owners of bearer shares must use a bank as a custodian of these assets, and banks are obliged to allow this information to be provided to law enforcement agencies, would have some positive effect of reducing crime. Criminals should be deterred from using bearer shares for illicit purposes because any bearer share related transactions would leave a visible 'paper trail' which would increase the probability of successful criminal prosecutions for transgressions in this area, and law enforcement would derive benefits in terms of enhanced efficiency and effectiveness of investigations as a result of this paper trail.

155. Therefore introducing mandatory custodian arrangements for bearer shares would lead to reduced crime which could increase the level of economic activity and reduce negative subjective wellbeing impacts.

156. However, a custodian arrangement would arguably have a lesser impact than abolishing bearer shares outright. For example, the administrative savings would be attenuated for law enforcement who would still need to follow a paper trail, and perhaps an imperfect one.

157. There is a lack of evidence regarding which of the two options would have the greatest impact on crime, and there is always potential for criminals to find new ways to evade enforcement. While the abolition of bearer shares is considered the preferred option to secure the full benefits of international action to combat crime and comply with the highest standards, the mandatory custodian option is a suggested recommendation by FATF and would likely fulfil the Global Forum criteria to identify who owns companies.

158. However it is clear that the mandatory custodian option would not give the full benefits of international recognition for action to combat crime (although a suggested recommendation by FATF), and so the abolition of bearer shares is considered the preferred option to comply with the highest standards.

B2. Benefits to companies and individuals from corporate transparency supporting the business environment

[304] Companies House invoice 2013.

[305] See the assumption section of the impact assessment for a discussion of the potential implications of relaxing the assumption of 100% compliance on communications costs.

[306] Companies House internal estimate 2013.

159. In contrast to outright abolition of bearer shares, there would be no benefit from increased transparency derived from a custodian arrangement accruing to bearer share issuing companies, individuals and other companies, associated with increased economic activity arising from increased transparency. This is because the financial intermediary acting as a custodian for bearer shares would not (be obliged to) provide information about bearer shareholders to third parties (since law enforcement agencies could access details held by the custodian bank).

Costs

C1. Cost to individuals/businesses who own bearer shares: anonymity and transferability costs

160. There are costs that could fall to law abiding users of bearer shares from the loss of anonymity and transferability resulting from the abolition of bearer shares. Unlike abolition, a custodian arrangement would not remove anonymity nor necessitate moves to alternative arrangements to provide it, and there would be no consequent cost.

161. However, there is a cost associated with individuals losing a degree of transferability, because there would be transaction costs associated with interacting with the custodian bank in making arrangements to transfer the immobilised bearer share. We assume that this ongoing loss of transferability is the same as under Option 1 (**£6k**).

C2. Cost to individuals/businesses who own bearer shares: familiarisation, administration and time costs

162. There would be a familiarisation cost associated with bearer shareholders understanding the custodian requirements. In the absence of any evidence to the contrary, we assume the costs would be the same as under Option 1 (abolition), on the basis of the same number of shareholders being involved and a similar level of information and understanding being required. Therefore we assume that transitional familiarisation costs would be **£288k**.

163. There would not be time and monetary costs to converting bearer shares to registered shares, because it would still be possible to own these assets in the form of bearer shares under the new arrangement.

C3. Cost to companies who issue bearer shares: financing costs

164. In the context of abolition of bearer shares, we discussed an impact on financing for bearer share issuing companies. Since a custodian arrangement would maintain the anonymity of bearer shareholders with respect to the general public, they would still be attractive to potential shareholders who place an economic value on keeping their identity secret (e.g. because they are vulnerable or do not wish to disclose commercially sensitive information). Therefore companies which wish to issue bearer shares would not be forced to discount their equity or incur costs by so doing.

165. However, a custodian arrangement does not maintain the transferability of bearer shares, and it is theoretically possible that there would be some financing cost if a proportion of the market valued the transferability of bearer shares; companies may need to offer their equity at a lower price or pay higher dividends in compensation which represents an ongoing unquantified cost.

C4. Cost to companies who issue bearer shares: familiarisation, administration and search costs

166. There would be a familiarisation cost associated with bearer share issuers and relevant financial institutions understanding the requirements of the policy change to a custodian arrangement. We assume that the unit costs would be the same as under Option 1 (abolition) since the information requirement is broadly similar. However, there are also potentially 310 banks[307] that would need to be familiar with the changes as well as the 779 bearer share issuing companies identified above. This means that an estimated 1089 entities in total (779+310) would incur familiarisation costs. Therefore we estimate this transitional cost to be **£105k** (1089 * 96) (rather than £75k under Option 1).

167. Unlike in the case of the abolition of bearer shares, issuing companies would not be required to convert existing shares. Therefore there would not be an administration cost to issuing companies unlike under Option 1.

168. The company might still incur search costs in terms of seeking to identify its bearer shareholders. As under Option 1, these are not readily quantifiable, but would derive from the need to make a 'reasonable attempt' to find the shareholder. We did consider using information from the *Transparency and Trust* Survey as a proxy but there was not an appropriate analogy to draw upon.

C5. Cost to custodian

169. Since a bank will need to hold the bearer share, they will incur (and likely pass on) costs. It would be at the custodian bank's discretion as to how they held and registered bearer shares and their owners, but at a minimum, we would likely require the name and address of the shareholder to be held. There will also be a requirement to hold this share in a secure location, such as a vault, where it could be ensured that the share is immobilised.

170. Ideally, we would want to estimate the following relationship:

171. (Number of bearer shareholders) * (custodian cost per bearer shareholder)

172. In order to generate an estimate, we have pursued the following approach.

173. We assume that there are 3000 bearer shareholders based on the analysis above (and again we assume 100% compliance). Evidence suggests that bank storage box prices can range between £120 a year and £480 (which we assume would include the cost of registering the owners' details), and in the absence of alternative information we assume a midpoint of £300[308]. Multiplying this by the estimated number of bearer shareholders gives an ongoing cost of £0.9m. If there are additional costs to the custodian from holding and administering the shares on behalf of the bearer shareholder (for instance in handling proxy voting), this will be an underestimate.

C6. Costs to government

174. There would be a need for an information campaign to inform present and future holders of bearer shares that they must place these shares with a custodian institution.

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[307] http://www.fsa.gov.uk/library/other_publications/banks

[308] http://www.thisismoney.co.uk/money/saving/article-2312085/Barclays-tells-safe-deposit-users-clear-out.html#ixzz2hXLiGQE.

175. We would assume that these costs could be broadly the same as under prohibition. This is because the Government would still need to contact each issuing company directly using a similar mechanism and the issuing company would still have the responsibility to communicate to the bearer shareholders. However, the Government would need to write to 25% ((1233+310)/1233) more institutions because they would also need to communicate with the 310 banks. We up rated the costs accordingly by the same proportion. Therefore this transitional cost is **£1k** (see Option 1).

176. The transitional development for Companies House costs estimated under Option 1 would not be relevant in this case because bearer shares would not be prohibited.

G. Rationale and evidence that justify the level of analysis used in the Impact Assessment (proportionality approach)

177. We believe that the analytical approach taken in this Impact Assessment is proportionate. The table below sets out the data we would have required in order to have obtained a full monetised analysis and why we were not able to include this.

178. The *Transparency and Trust* package was started with initially very limited evidence, primarily because the criminal nature of the problem we are targeting makes data collection challenging. Moreover, the breadth of the areas addressed in the package has not been studied in detail before.

179. Prior to the launch of the *Transparency and Trust* paper we carried out a number of discussions with industry, Non-Governmental Organisations (NGOs) and regulated bodies such as banks, lawyers and accountants; both during and after the G8 process. We also ran an online non-representative survey to gain initial cost estimates, and considered previous research in this area. During the consultation on the *Transparency and Trust* paper, which fed into the evidence base underlying this Impact Assessment, we have:

- consulted with the Economic and Social Research Council;
- consulted with Companies House;
- undertaken a full literature review;
- opened an online survey accessible by the general public;
- consulted with business, regulated entities and law enforcement agencies in a series of focus groups and one-to-ones;
- written to bearer share issuing companies; and
- commissioned a company survey through IFF Research (see Annex A).

180. After the publication of the *Transparency and Trust* discussion paper, we undertook a series of focus groups as well as an online survey, and have continued to closely engage key stakeholders.

181. Throughout this process, the evidence gathered from stakeholders has and will continue to play a key role in our ability to determine which policy options will have the desired effect, without unintended consequences or imposing unnecessary burdens on business.

182. In terms of examining the benefits of corporate transparency for the business environment and those operating within it, Companies House and FAME data first enabled us to identify the population of companies in scope. Once we had conducted a detailed literature review, which made good use of the expert knowledge within the Economic and Social Research

Council, we were then able to identify the associated benefits of the *Transparency and Trust* package, including evidence of the important relationship between trust and economic growth. In general, however, the relevant economic literature is in its infancy, which made it unfeasible to monetise the benefits of corporate transparency on the business environment.

183. The benefits arising from the potential reduction in crime could not be fully monetised because of the way in which law enforcement agencies collect their data. Given the huge scale of any corporate investigation and the myriad of evidence, there is no systematic distillation of crime data such that we can interrogate the impact of a single factor, such as corporate opacity or specifically the misuse of bearer shares. We have offered an indication of the scale of the potential benefits but without estimates of the deterrent effect on crime resulting from *Transparency and Trust* measures, we could go no further to monetise them.

184. The evidence we have gathered to inform cost estimates in this Impact Assessment is drawn in large part from a company survey we commissioned through IFF Research. The study was the first of its kind, analysing in detail the costs associated with enhancing corporate transparency. Despite the lengths we went to in order to gather evidence there was still a need for processing of the data to obtain estimates for use in this Impact Assessment, and timing and proportionality constraints with respect to further interrogation of the responses provided to the survey (see Annex A).

185. We are satisfied that the evidence presented here represents the most comprehensive and robust assessment available for a Consultation Stage Impact Assessment within the constraints of proportionality, with respect to both cost and time. As we develop the evidence base to progress to a Final Stage Impact Assessment we will continue to develop all the sources of evidence available, subject to proportionality constraints.

	Evidence/Data gap	**Why this evidence has not been included in the IA**
Benefit		
BI. Benefits to government, individuals and business of a reduction in illicit activities	Number of firms benefiting *effect of measure on business transparency per company* average effect of business transparency on economic activity Number of firms benefiting*effect of measure on business transparency per company* average effect of business transparency on investment	Lack of evidence in the literature During the consultation, none of the respondents were able to provide quantified evidence in this area. This was often due to data not being recorded in such a form which is easily accessible or usable for economic appraisal purposes
B2. Benefits to companies and individuals from corporate transparency supporting the business environment	Total reduction in crime Unit costs specifically relating to bearer share related fraud rather than general fraud	Lack of evidence in the literature During the consultation, none of the respondents were able to provide quantified evidence on the total reduction in crime. This was often due to data not being recorded in such a form which is easily accessible or usable for economic appraisal purposes Evidence from the Home Office

	Evidence/Data gap	Why this evidence has not been included in the IA
		does not disaggregate by type of fraud and only gives a high level aggregate figure
Costs		
General assumptions relating to costs	The total number of bearer shareholders (rather than an estimated average based on all shares) The proportion of bearer shareholders who comply with the new regulations	Given the nature of bearer shares and the anonymity they provide it is not possible to measure the number of bearer shareholders ex-ante without asking each company to obtain and provide this information There is a lack of international evidence on proportions who comply with the new regulations
C1. Cost to individuals/ businesses who own bearer shares: anonymity and transferability	The benefits associated with anonymity under abolition for Option 1	Lack of academic literature in this area Lack of response to questions in this area in the consultation
C3. Cost to companies who issue bearer shares: financing costs	Value issuing companies place on bearer shares	Lack of evidence in the literature in this area Lack of response to questions in this area in the consultation
C4. Cost to companies who issue bearer shares: familiarisation, administration and search costs	Search cost associated with locating owners of bearer shares	The current policy position is that companies issuing bearer shares have to make reasonable attempts to locate owners of bearer shares. In the fullness of time there will be development of the meaning of 'reasonable attempt' and this estimate can be refined

Table 2: Gaps in the evidence base and explanation

H. Risks and assumptions

186. The risks and assumptions relevant to this Impact Assessment are set out below:

Listed companies

187. We are aware that some UK listed companies may use a very limited number of bearer shares to facilitate issuing shares on foreign markets. Initial evidence suggests that these companies can readily identify the owner of the bearer shares in question, but that prohibiting their issuance may impact the smooth functioning of the market in this area. We are continuing to explore the scale and nature of this issue and we may need to consider, in future, whether this will require a separate policy response. One option may be to put in place a custodian-type option (as under Option 2) for these companies which would impose costs on these businesses.

The link between trust and economic growth

188. The evidence suggests that the *Transparency and Trust* package will as a whole have benefits with respect to growth because of its impact on trust. However, our ability to disaggregate to the level of individual component parts of the package, specifically regarding

bearer shares, is limited. We assume the growth impact will be non-negligible when combined with the rest of the package. We have also made assumptions in adopting the approach of 2006 to the relationship between trust and growth. The mechanism through which increasing transparency is considered to affect growth is the enhancement of trust in the business environment. However, the majority of the academic literature related to trust and growth looks generally at societal level trust. Beugelsdijk (2006) considers 'trust' a good proxy for trust in the business environment because trust according to the World Values Survey measure is highly correlated with the effectiveness of institutions.

Interactions with other policy measures

189. We assume no interaction with EU proposals covering the de-materialisation of shares. EU proposals, currently under negotiation, seek to remove the ability for paper share certificates to be issued and traded on regulated markets. We assume this would prohibit bearer shares from being issued and traded by companies who trade their shares on regulated markets. Since our evidence suggests limited use of bearer shares by companies which trade their shares on regulated markets we assume that there is limited policy interaction between the EU proposal and our proposal. Therefore, there is no benefit to conversion schemes being run in parallel given the different cohort of companies. There is in addition an underlying benefit to taking forward the proposals on bearer shares as soon as possible to ensure the UK is compliant with international recommendations on tax transparency by the Global Forum.

Compliance and criminal activity

190. Following standard Impact Assessment methodology, we have assumed 100% compliance. There is, however, a risk of non-compliance and an impact on the criminal justice system. This is set out further below.

191. There is a lack of evidence from international examples to understand the proportion of bearer shareholders who would not convert by the end of the transition period. This leads to a risk that there might be additional costs associated with bearer shares which remain unconverted at the end of the conversion period. Unidentified shares may ultimately be cancelled by the court. This would entail costs to the court system.

192. If the 100% compliance assumption doesn't hold then there may also potentially be additional communication costs (C5 under Option 1 and C6 under Option 2) to Companies House associated, for example, with writing to firms who have not taken steps to convert their bearer shares.

193. Related to the previous point, there is a risk that benefits from a reduction in criminal activity will not be profound, or that individuals willing to undertake criminal activity might find other ways to hide their interest or involvement in a company. This is not anticipated in this Impact Assessment, but it might have an impact on the level of benefits achieved by the proposals. This risk is likely to be mitigated by robust action being taken across the *Transparency and Trust* package, as envisaged by the suite of proposals. Moreover, crime estimates were only available for England and Wales so we scaled them up to cover the whole of the UK. This enabled us to calculate the volume of crime committed and the associated costs across the whole of the UK.

International displacement of crime

194. There may be a risk in terms of individuals opting to use non UK companies (rather than UK companies) to facilitate crime, which may still have an impact in the UK. Again this risk will be mitigated by ongoing UK action in the G8, G20, FATF and in Europe to encourage other jurisdictions to take similar action.

The potential for collusion

195. There is a risk that individuals and companies could act together to seek to prevent the conversion of bearer shares. However, companies are required to provide Companies House with details of their shareholders on an annual basis, and should their return state shares owned by "bearer" there would be scope for enforcement action as appropriate. If the company were to provide false information in their return to Companies House, action may be taken under existing offence provisions in the Companies Act 2006.

The risk of an adverse impact on overseas investment

196. There is a risk that we have not accurately accounted for a potential impact on overseas investment in the UK and UK competitiveness arising from the package as a whole.

197. The OECD has noted as a general principle that *"excessive compliance costs, shortening the disclosure period and information overload problems, discourage (foreign) investments in listed companies and negatively affect shareholder engagement*[309]." They also note that *"costs of a disproportionate and stringent disclosure regime makes it more difficult for emerging growth companies to attract public investors, these companies will be induced to rethink their stock market aspirations, thereby hampering economic growth and job creation*[310]". These issues might well be relevant for non-listed companies also.

198. Overall, the risk of accounting for this effect with respect to the *Transparency and Trust* package must be contextualised with respect to the significant influence of many other factors on the UK's ability to attract investment. The UK is the 10th most competitive economy in the world (WEF, 2013). The World Economic Forum (WEF) highlights the UK strengths in technology, labour market efficiency, infrastructure, business sophistication and market size, which will by no means be eroded by greater corporate transparency.

199. The main drivers of Foreign Direct Investment would not be likely to be adversely affected by the *Transparency and Trust* package, and indeed could be positively affected. Generally, strong economic fundamentals are thought to be the most important determinants (OECD, 2002). In most cases, these include comparative advantage, political and macroeconomic stability, market size, real income levels, the skills base and the quality of the infrastructure (with anonymity of ownership not explicitly referenced as an attractive factor).

200. Moreover, in considering these issues, we should weigh any potential deterrence of investment arising from transparency against the reduced information asymmetry between principals and agents leading to optimal investment and increasing mutually beneficial trades, and a potential increase in the UK's integrity and international reputation as a place to do

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[309] Vermeulen, E. (2013), "Beneficial Ownership and Control: A Comparative Study - Disclosure, Information and Enforcement", OECD Corporate Governance Working Papers, No. 7.

[310] Kamar, E., P. Karaca-Mandic and E .L. Talley (2008), "Going-Private Decisions and the Sarbanes-Oxley Act of 2002: A Cross-Country Analysis", USC Center in Law, Economics & Organization Research Paper No. C06-5, USC Law Legal Studies Paper No. 06-10; UC Berkeley Public Law Research Paper No. 901769.

business and invest. It is not possible, however, to place a monetary value on either any lost investment or possible increase. We did note, however, that companies with foreign ownership did not, in the surveyed sample, appear to cite higher costs than other companies for familiarisation or compliance with proposals in the *Transparency and Trust* package.

201. In policy terms, we will mitigate the risk of an adverse impact on UK investment by promoting this measure as one of many positive features of the business environment in the UK and continuing to encourage action from other jurisdictions. This will include an active approach in the G8, G20, FATF and in Europe, and through wider promotion of the importance of corporate transparency (e.g. through international best practice guidance and standards). This package of policies places the UK at the very forefront of the international transparency agenda. This has already resulted – and will continue to be a key factor – in the UK shaping the international debate and driving international change.

The length of the conversion period

202. We have assumed that bearer shareholders will have 12 months to convert their shares to registered shareholdings. This reflects the anticipated policy at the time of writing. However it is possible that ongoing policy discussions could lead to this assumption being changed. This will be reflected in the Final Stage Impact Assessment.

Companies House development costs

203. The costs to Companies House referred to in C5 under Option 1 only account for development and do not include any other business costs such as training or communication. If there is insufficient internal development resource external resource may be required which would cost significantly more.

I. Direct costs and benefits to business calculations (following OITO methodology)

204. The measures the UK has committed to at the G8 are out of scope of One In Two Out on the grounds of implementation being required to meet international obligations.

205. The G8 is a forum that brings together eight global leaders (Canada, France, Germany, Italy, Japan, Russia, UK and USA, alongside the EU) to address international issues and tackle the most pressing global challenges. The G8 Presidency runs for one calendar year and rotates among the eight member countries, giving each member the opportunity to set the agenda and hold the other Leaders to account. The UK held the 2013 Presidency, and the Prime Minister hosted the annual G8 Summit at Lough Erne in June. The agreements and commitments made by G8 leaders are set out in a formal communiqué published at the annual Summit. These commitments are public and binding.

206. At last year's G8 Summit the UK committed to an Action Plan to prevent misuse of companies and legal arrangements[311] from which the measures set out in this Impact Assessment are drawn. Strong action to deliver a package of reform based on the Action Plan is now the minimum the UK must deliver to meet its international obligations. Each other country has published an Action Plan based on common G8 principles.

207. With respect to accountability for the international commitments the UK has made, the Prime Minister and G8 leaders have publicly agreed to "ensure G8 members are held to account for their commitments, [on which basis] the G8 agrees to a process of self-reporting through a

[311] June, 2013: https://www.gov.uk/government/collections/g8-communique-and-documents.

public update on the progress made against individual Action Plans and to inform the Financial Action Task Force [FATF].” A FATF follow-up of the implementation of G8 Action Plans is scheduled for presentation in 2014.

208. In addition, since 2009, the G8 has completed an annual accountability exercise to hold itself to account for the development and development-related commitments which are made at G8 Summits. Every three years a comprehensive report reviews all of the commitments within this scope whilst in the intervening years, the Presidency chooses sectors to include in an in-depth report. Each commitment is scored on a five point red/amber/green rating either for the G8 collectively or for individual G8 members depending on the commitment. Moreover, G20 Finance Ministers will report back to G20 Leaders in 2014 on progress made against a commitment in that forum to lead by example to increase transparency of company ownership and control.

209. Nevertheless, in the interests of good practice, we have calculated that the preferred option has a direct cost to business of £0.1m and a direct benefit to business of zero. This gives a net direct cost to business per year of £0.1m.

J. Wider impacts

Statutory equality duties

210. This policy will primarily have an impact on a small number of UK companies and those who hold bearer shares in them. We have considered whether any of the following groups might be adversely or positively impacted by this policy in different ways:

- Race Equality;
- Gender;
- Disability;
- Age;
- Marriage and civil partnership;
- Religion and Belief;
- Sexual Orientation;
- Gender Reassignment; and
- Pregnancy and Maternity.

211. Assuming 100% compliance, with suitable transitional timeframes in place for the conversion of existing bearer shares, we see no concerns in these areas. We are unable to quantify and have no reason to anticipate that any people within these areas possess a disproportionate holding of bearer shares (owing to their anonymous nature).

Economic impacts

i. Competition impact test

212. Analysing the measure against the competition questions set out in the guidance did not identify any particular concerns in this area

ii. Small and micro business assessment

213. For the purposes of this assessment, the parameter used to define small businesses is up to 49 full-time employees, and for micro businesses up to 10 employees.

214. As set out above, the two main objectives of the *Transparency and Trust* package are to reduce crime, and improve the business environment so as to facilitate economic growth. The

assessment is that excluding small and micro businesses from the policy package could risk a significant impact on the ability of the package to reduce crime, and exclude small and micro businesses from the benefits that can be derived from increased transparency.

215. It has been widely identified that ‘shell’ companies are often the vehicle of choice for money-laundering and other crimes.[312] A 2012 study defines a shell company thus: *“In contrast to operating or trading companies that have employees who make a product or provide a service […] shell companies are little more than this legal identity, and hence the “shell” moniker”.*[313] By this very definition, we believe that the majority of shell companies would be classified as small and micro businesses. Law enforcement have strongly confirmed to us that this is the case, and that excluding small and micro businesses from scope would be a significant risk and ultimately counterproductive.

216. Allowing any exemptions targeted at small and micro business could therefore have a negative impact on the primary derived benefit from this policy, in terms of a failure to tackle or deter any illicit activity undertaken through companies currently on the register. Exempting small and micro businesses from the requirement would create a significant loophole for those seeking to exploit the company structure for illicit activity in future. In turn, this could damage the reputation of UK small and micro businesses relative to their larger and/or international competitors.

217. Moreover, any exemption for small companies would limit the positive impact on the wider building of trust in the business environment - and therefore economic growth. Were they to be exempted from these transparency requirements, information asymmetries could persist and law-abiding businesses might find themselves, for instance, less able to attract private investment or debt finance.

218. Nevertheless, from the outset we have considered measures to minimise burdens to small and micro businesses, and will continue to develop these as a priority for implementation. As a first step, we will ensure there is sufficient time for companies to familiarise themselves with these changes. We will provide quality guidance, using a variety of media and well-tested and trusted techniques, to begin to operationalise the new system. We will take steps to identify and fulfil any particular guidance requirements of small and micro businesses in order to support them, in particular, in understanding the new requirements. According to further feedback, we will develop this guidance to particularly support those in small and micro businesses who are seeking to take on compliance ‘in house’ without internal or external expertise. Guidance for the reforms will be tailored to the majority of companies, which are small, simple in structure and law-abiding. This will enable small companies to quickly grasp whether or not the abolition of bearer shares is relevant to them and it will help them to easily assimilate the compliance requirements where they do apply.

219. We will also continue to develop the implementation of the policy change to be as simple as possible for all users but particularly those in small and micro businesses, in terms of interfaces and forms etc.

220. We have not identified any other potential unintended effects to these businesses, and assuming 100% compliance, the policy will not disproportionately impact small and micro businesses. Given the lack of evidence in this area it is not possible to analyse the impact of the

[312] ‘Global Shell Games: Testing Money Launderers’ and Terrorist Financiers’ Access to Shell Companies’, Findley, Nielson and Sharman, 2012: http://www.griffith.edu.au/business-government/centre-governance-public-policy/research-publications/?a=454625.
[313] As above.

policy on small versus large companies by analysing differences in costs for different sizes of companies.

221. With these points in mind, our assessment against the advised considerations is as follows:

Full exemption

222. We do not believe a full exemption is compatible with achieving a large part of the intended benefits. Companies House estimate, based on assumptions regarding accounts filed, that 78% of bearer share issuing companies (960/1233) are small[314]. We are unable to calculate the number of small firms who own bearer shares as we do not have detailed information on ownership due to the 'anonymous' nature of bearer shares.

223. However, in the context of companies being used as vehicles for crime, it is often small companies that might be thought to pose the most risk. It would not be possible to exclude small or micro firms from the proposals, since this would allow nefarious individuals to circumvent the objectives of the legislation through using small companies and bearer shares for illicit activity.

224. During our call for evidence on the proposed measures, we contacted all known bearer share issuing companies, including small companies; 34% suggested that '[bearer] shareholders are personally known, dividends are not divided, but re-invested in capital' – which would support the Companies House estimate that these companies are small. Within this sample, it appeared that these 'small' firms actually reported a lesser impact of converting bearer shares than larger companies.

225. For this reason, we do not expect small and micro businesses to have bearer shares remaining at the end of the conversion period, as the conversion of their bearer shares should be straightforward to achieve. The stage following this, where we anticipate companies may need to apply to court to cancel any bearer shares that remain outstanding, is the only stage of the transitional arrangement which we believe may be particularly burdensome for small and micro businesses.

Partial exemption

226. At this stage, we have not identified any specific requirements within the regulations which we would be able to exempt. For the aforementioned reasons, we do not believe any exemption is compatible with achieving a large part of the intended benefits.

Extended transition period

227. We do not believe a separate transition period for small and micro companies is compatible with achieving a large part of the intended benefits or achieving compliance with international standards. We will ensure that a sufficient transition period is in place for all companies.

[314] Companies House analysis, 2013.

Temporary exemption

228. We do not believe a temporary exemption for small and micro companies is compatible with achieving a large part of the intended benefits or achieving compliance with international standards. We will ensure that a sufficient transition period is in place for all companies to familiarise themselves with changes (see ‘K’).

Varying requirements by type and/or size of business

229. As small, anonymous shell companies are the focus of our proposals it would not be appropriate to vary the requirements for small and micro companies. It would also not be appropriate to delineate by sector or any other type of business, since this would produce the same issues in terms of incomplete coverage and loopholes. This would not be compatible with achieving a large part of our intended benefits.

Direct financial aid for smaller businesses

230. We do not believe that the costs of complying with this policy change will be significant. Furthermore, we anticipate that the majority of these will be one-off costs.

Opt-in and voluntary solutions

231. We do not believe that small and micro businesses’ having to follow this regulation voluntarily is a viable solution and compatible with achieving a large part of our intended benefits or achieving compliance with international standards. We believe that those who intend to hide criminal funds will simply continue to do so without regulation.

Specific information campaigns or user guides, training and dedicated support for smaller businesses

232. There might well be a case for tailored information campaigns and user guides, though training is not likely to be required. We will work on meeting the needs of the small and micro business user as we develop overall guidance to support the introduction of the package, and as part of the Government’s wider communications campaign.

Environmental impacts

233. Preliminary analysis suggests there are no concerns in this area.

Social impacts

i. Health and well-being

234. Preliminary analysis suggests there are no concerns in this area. Reducing crime should help to improve wellbeing.

ii. Human rights

235. Following consideration of the policy in relation to human rights, we believe any potential impact will be mitigated by the transitional measures that are an inherent part of this package.

236. In assessing this impact we gave particular consideration to an individual's property rights and we are satisfied that there is no impact in relation to prohibiting the future issue of bearer shares. In relation to abolishing existing bearer shares, we believe that an individual's property rights would most likely not be affected because individuals and issuing companies will have adequate time and notice to convert their bearer shares to registered shares. Moreover, this proposal does not remove the holder's right to a dividend, to participate as a member of the company, or to sell the shares - it simply amends the form that these rights take. There is therefore limited loss of benefits to the holder in legal or economic terms.

237. Additionally, there is an internationally agreed necessity for greater transparency of who owns and controls companies (e.g. the recommendations of the *Global Forum on Transparency and Exchange of Information for Tax Purposes*) which provides a public interest justification for any interference with property rights.

Justice system

238. Justice Impact Tests are currently under discussion with the Ministry of Justice.

239. This Impact Assessment assumes 100% compliance with the policy. A Justice Impact Assessment Test has also been completed. In the event that there is not 100% compliance, there will be two areas of potential cost for the justice system.

i. Enforcement action

240. We anticipate that we will extend the application of existing company law offences or use existing company law offences as a precedent for the creation of similar offences to deal with instances where companies or shareholders fail to comply with the policy reforms.

241. We anticipate however that most instances of non-compliance would be dealt with by Companies House through their usual compliance procedures. For example, Companies House estimate that in 85-90% of cases they write to the company in the first instance, before referring the matter to BIS or other enforcement agencies, or taking action themselves.

ii. Court process for cancellation of non converted bearer shares

242. As outlined above in the description of Options considered, we anticipate that where a company has unconverted bearer shares at the end of the conversion period, the company will be required to apply to the court for the cancellation of those shares.

243. This process will be refined as the policy is further developed. However, we anticipate that any impact on the court system will be minimal. This is because the policy will only affect 1233 companies and an estimated 3,000 shareholders/agencies in total. We believe we have allowed sufficient time, mechanisms and incentives for companies to identify their bearer shareholders; and for shareholders to come forward and convert their shares. We therefore anticipate that the proportion of companies who must apply to court will be low.

Rural proofing

244. Preliminary analysis suggests there are no concerns in this area.

Sustainable development

245. Preliminary analysis suggests there are no concerns in this area.

Devolved administrations

246. We do not record figures on the location of different shareholders within the UK. We have identified that the majority of bearer share issuing companies are incorporated in England and Wales (1188), with only a minority in Scotland (45). However, the company itself could be geographically based and conduct the majority of its business activities anywhere in the UK or abroad.

Summary and preferred option with description of implementation plan

247. The summary and preferred option are set out below:

248. A Multi-Criteria analysis can be used to compare the costs and benefits of the policy options. This is set out in Section F.

249. On the basis of this analysis, it can be seen that Option 2 performs better than Option 1 in terms of having lower quantified transition costs. This is because Option 2 does not require shares to be converted (the conversion process imposes costs on bearer share owners and issuers). It also has lower unquantified ongoing costs, in terms of the impact on bearer share owners and issuers of forgone anonymity for owners.

250. However, we recommend Option 1 because it has greater unquantified benefits around stimulating economic activity. Moreover, the Net Present Value is much more favourable (-£1.34m compared with -£8.19m under Option 2). The difference in Net Present Value arises because Option 1 doesn't require the large ongoing costs associated with Option 2.

	Option 1 (abolition)	Option 2 (mandatory custodian arrangement)	Which option is performs better?
Benefits			
BI. Benefits to government, individuals and business of a reduction in illicit activities	Unquantified benefit	No benefit	Option 1
B2. Benefits to companies and individuals from corporate transparency supporting the business environment	Unquantified benefit	Unquantified benefit (potentially smaller than Option 1)	Option 1
Costs			
C1. Cost to individuals/ businesses who own bearer shares: anonymity and transferability	Cost to owners of forgone transferability £6k (ongoing) Unquantified cost to forgone anonymity	Cost to owners of forgone transferability £6k (ongoing) No unquantified cost to forgone anonymity as the general public would not have access to information held by the custodian institution	Option 2
C2. Cost to individuals/ businesses who own bearer shares: familiarisation, administration and time costs	Familiarisation costs of £288k (transition) Administration and time cost of converting shares of £41k (transition)	Familiarisation costs of £288k (transition) No administration or time cost because it would still be legal to hold bearer shares	Option 2
C3. Cost to companies who issue bearer shares: financing costs	Unquantifed cost	Unquantifed cost (expected to be lower as no loss of anonymity impacting negatively on the equity offer)	Option 2
C4. Cost to companies who issue bearer shares: familiarisation, administration and search costs	Familiarisation costs of £75k (transition) Administration costs associated with converting the shares (legal charges) of £840k (transition) Unquantified search cost associated with locating owners of bearer shares	Familiarisation costs of £105k (transition) No administration cost associated with changing shares because it would still be legal to own bearer shares	Option 2
C5. Costs to government of publicising policy changes	Communications costs of £1k Companies House development costs of £39K	Communications costs of £1k	Option 1
C6. Cost to custodian	No custodian costs under this arrangement	Custodian costs relating to storage of £900k (ongoing)	Option 1

Table 3: Comparison of costs and benefits of Options

i. Implementation plan

251. At the UK-chaired G8 Summit in June 2013, and following six months of international negotiation (led by the Cabinet Office on behalf of the UK), G8 Leaders recognised the problem of corporate opacity, including in respect of bearer shares, and agreed to publish national Action Plans setting out the concrete steps they would take to address this.

252. The UK published its Action Plan at the Summit, which set out a number of commitments, including the commitment to review corporate transparency, including bearer shares. BIS, as the department with responsibility for company law and corporate governance, is responsible for the implementation of this commitment, working closely with other government departments including HM Treasury and HMRC.

253. In July 2013 BIS therefore published a discussion paper setting out measures to enhance the transparency of UK company ownership. This included proposals to prohibit bearer shares. This Impact Assessment reflects the outcome of that call for evidence, as well as the other evidence gathering mechanisms outlined in this document.

254. This reform necessitates primary legislation. It is therefore our intention to take forward this policy as soon as Parliamentary time allows.

255. Once the policy has completed its Parliamentary passage, we would seek to implement the following high level implementation plan:

- Prohibit the issuance of new bearer shares by UK companies on commencement of the legislative measures;
- Provide a set period of time (anticipated at this stage to be around 12 to 15 months) for the conversion of existing bearer shares; and
- Put in place measures to provide for the cancellation of any bearer shares that remain unconverted at the end of the conversion period.

256. This plan will be refined as the policy - including transitional arrangements and related proposed changes to company law - is further developed.

Annex A – Methodology: The IFF *Transparency and Trust* Survey

A. Background

1. During consultation on the *Transparency and Trust* discussion paper, to inform policy development and the Impact Assessment process, we have:

- consulted with the Economic and Social Research Council;
- consulted with Companies House;
- undertaken a full literature review;
- opened an online survey accessible by the general public;
- consulted with business, regulated entities and Law Enforcement Agencies in a series of focus groups and one-to-ones meetings; and
- undertaken a large scale company survey.

2. On this final point, IFF Research conducted a survey of UK companies on behalf of BIS, starting in August 2013. BIS worked with IFF to develop a mix of qualitative questions and quantitative cost estimates of 574 companies. The survey was intended to examine the impact of proposed corporate transparency reforms on a range of companies, of varying size and ownership structure. Companies were asked questions in order to explore the likely cost impact of establishing a central registry of beneficial ownership, opaque arrangements involving company directors and the disqualification of certain directors.

3. In order to allow us to derive estimates of costs, the questions asked typically requested information on which members of staff would be involved in a given compliance process and how long it might take, and some direct questions relating to costs.

4. The total cost figures were calculated based on estimates for the number of hours it would take particular employees to comply with the proposals. Once IFF Research compiled these data, they were multiplied by the hourly wage rates taken from the Annual Survey of Hours and Earnings (ONS, 2012)[315].

B. Issues with the survey

5. In-depth analysis of the survey methodology and responses has since highlighted several issues. When the survey questionnaire was designed (August 2013), policy was in the early stages of development and remained the subject of consultation. The tight timeframe was necessary in order to inform the policy development and Impact Assessment schedule, but it has meant that the specific requirements of companies (e.g. the nature of familiarisation and compliance) were not fully defined, and therefore were not clearly or comprehensively presented to companies to inform their responses. In fact, IFF Research explained to BIS that some respondents struggled to answer the questions and some had varying interpretations as to what the questions meant for them.

[315] The statistics taken from ASHE are based on the median rather than the mean. This is the preferred measure of earnings as it is less affected by a relatively small number of very high earners and the skewed distribution of earnings. It therefore gives a better indication of typical pay than the mean. The survey takes a sample of employee jobs drawn from HMRC records of gross pay before tax, National Insurance or other deductions. These data were then uplifted by 17.8% to reflect non-wage costs (i.e. National Insurance, pension contributions, other payroll taxes and other non-statutory employee services such as transport and canteen provision). This is in accordance with Eurostat data and forms a standard assumption.

6. We believe these issues have had an effect on the robustness of the **responses and therefore on their overall suitability for unqualified use in analysis of the costs and benefits of the proposed** reforms and their role in our Impact Assessments. These are outlined below.

7. We identified a number of striking distributions across the survey questions. The data we received showed a number of respondents who estimated costs which were extremely high, in contrast to a 'long tail' of respondents who estimated zero costs.

8. For instance, the question relating to familiarisation costs for the creation of a register of beneficial owners, yielded the following distribution of responses:

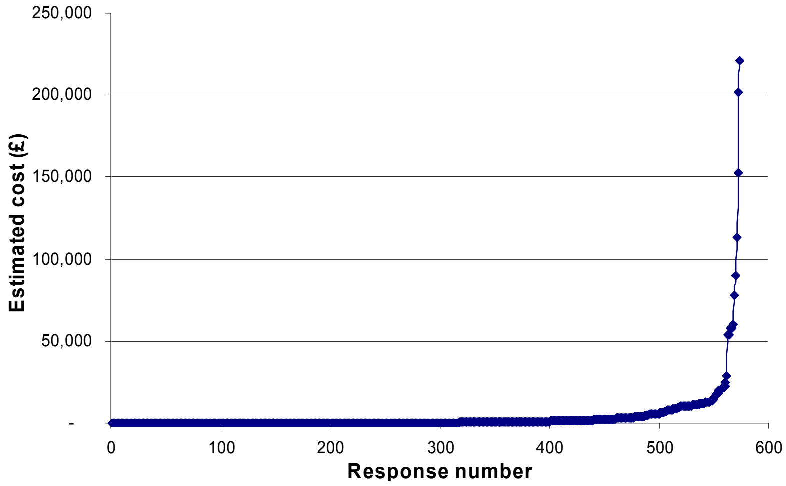

Figure A1: Distribution of responses on the costs of familiarisation related to beneficial ownership

Staff cost (£)		Additional costs (£)		Total costs (£)	
Mean	Median	Mean	Median	Mean	Median
1,087	145	1,124	0	2,211	196

Table A1: Familiarisation costs related to beneficial ownership

9. Close interrogation of this 'tail' of high responses has not indicated any discernible pattern; that is to say, the companies which gave high responses did not consistently adhere to any identifiable characteristics. We might have expected higher costs for larger and more complex companies, but in the context of analysis of these respondents there was no relationship between cost[316] and size (based on turnover, employees and assets) and complexity (based on the number of layers of share ownership).

10. If we compare the estimates of familiarisation costs produced by the present survey to other estimates of familiarisation costs, they are revealed to be noticeably higher. Recent modelling from Companies House[317], indicates that the familiarisation costs for a broadly comparable measure are substantially lower; modelling indicated it would take companies 20 minutes to familiarise themselves with a comparable policy, which was multiplied by £19 – the mid point between the median wage and the wage of a company director – to give a total familiarisation cost of around £6. Discussion with business representative organisations suggested that estimates based on these parameters were likely to be reasonable.

316 Although there was a slight tendency for those giving high responses to be 'large' – around 60% were.
317 Detail in cost benefit analysis within consultation on Companies House Filing Requirements (October 2013, BIS).

11. We identified similar differences when comparing other parts of this survey to wider evidence; the ongoing costs of complying with the policy also appear to have been significantly overestimated. The present survey estimated costs for companies providing information on beneficial ownership to Companies House each year (as one part of the total ongoing costs) as set out below:

Staff cost (£)		Additional costs (£)		Total costs (£)	
Mean	Median	Mean	Median	Mean	Median
212	48	149	0	361	48

Table A2: Costs of reporting beneficial ownership to Companies House

12. The estimates in Table 2 are at odds with another previous estimate. In 2007, PWC were commissioned to produce an Administrative Burdens Measurement Exercise. This exercise estimated administrative burden of regulations across a number of policy areas. PWC estimated the cost of completing, signing and returning a Companies House form (form 69280) to be £10.73 per company, which uprated to 2013 prices is £12.39. This process is broadly comparable to the some of the requirements in the *Transparency and Trust* package (such as reporting simple information on beneficial ownership to Companies House) but, again, the IFF estimates look inexplicably high[318].

13. In addition, respondents who gave extreme values were not asked further questions to allow us to understand what drove their estimates. Analysis showed that the majority of the costs were driven by very high responses to questions relating to "additional costs" (as shown in Table 1); that is costs identified by companies in addition to staff time. These were quoted in asking the question as 'legal, third party costs, etc.' but the exact detail of what companies thought they would involve was not determined.

14. For the reasons set out above, we now believe that the survey questions which asked for cost estimates lacked the specificity required to elicit fully informed or meaningful answers. The combination of the methodological concerns, the discrepancy between different respondents and between these and other analyses points to the need for further analysis to understand the costs to business of these reforms. This is particularly the case since we are continuing to refine the policy.

15. We have used statistical techniques for this iteration of the impact assessment to adjust the impact of extreme values. The steps we have taken to process the data for use in the present Impact Assessment are set out below. We will pursue further analysis as a priority for the Final Stage Impact Assessment.

C. Methodology for the current Consultation Stage Impact Assessment

16. Despite its flaws, the survey is the most comprehensive dataset available, and we believe there is value in processing it to produce realistic and duly qualified cost estimates. As an interim measure, for this iteration of the Impact Assessment, we have truncated the mean to adjust for extreme values. As context for doing so, we have considered the evidence from sources as discussed above and our conversations with business representative organisations. We have also considered the issue of additional costs.

[318] For instance, the response to the survey question "Costs as a result of providing beneficial ownership information to a central register on an annual basis" yielded an unadjusted mean response of £160 – more than twelve times higher than the PWC figure for a similar process.

17. Firstly it is necessary to consider and exclude zero values from the estimated mean (which will have the consequence of increasing our estimated costs). A large number of survey respondents answered that there would be zero costs arising from the proposed policy changes. This seems counter-intuitive, because all companies would need to spend at least some time understanding a form, even if just to determine that no or limited action is necessary. Therefore these observations have been removed, in accordance with the standard BIS approach to estimating costs to business. We will test this overall assumption with respect to each question or facet of the costs in further research, which will feed in to the final version of the Impact Assessment.

18. It is also necessary to exclude implausible or unverifiable estimates at the opposite end of the distribution. We used the truncated mean for each survey question relating to costs based on the shape of the relevant distribution (i.e. truncating the mean where the costs go beyond what we would consider feasible on a question by question basis).

19. The aim of these two changes is to deliver a more realistic cost estimate to apply to the general population of companies.

20. The next issue relates to whether the responses to questions around additional costs should be included. As set out above, the responses to the non-staff costs were implausibly high when compared with other evidence sources. The question was open-ended and did not define the sorts of costs that should be included, and IFF reported that there were very significant differences in interpretation of these questions across respondents, with some highly unusual interpretations. They were clear that the lack of question specificity was a particularly acute issue with these questions. Therefore we decided to exclude these responses from our analysis. We intend to return to this issue in the further analysis which we will conduct for the next iteration of the Impact Assessment.

21. Below we analyse the total economic costs of the proposals relating to the prohibition of corporate directors (which were used as a proxy in this Impact Assessment) under Option 1 for simplicity. The table below only considers staff costs on the basis that non-staff costs should be excluded, as detailed above. Mean costs were used to produce total cost to business estimates.

22. The raw sample data were weighted according to their size and structure (as per the share of all companies in each of the 6 cells in the 3x2 grid) and according to the number of observations of each of the 6 company types in the sample. The process was as follows:

i) Percentage of the population in each of the 6 cells x number all sample observations (excluding zeros and truncated observations)
ii) Total number of non-zero truncated sample observations for each of the 6 cells
iii) Divide (i) by (ii)

23. This calculation was necessary for each truncated mean and for each cell because once the data were truncated, a given number of observations were removed from the sample. The weightings, therefore, needed to be adjusted for each truncation to ensure that raw sample data were not inappropriately weighted after observations were removed.

24. The table below indicates that mean familiarisation costs of £500 alongside £769 for removal and replacement for a company with a corporate director and £798 for the removal and replacement of a company which is a corporate director. This produces a total cost of £217m.

Once the top 1% of data are truncated (and the zero responses are excluded as per all of the truncated means) the estimated total cost to business falls substantially to £78m.

25. Our analysis of the individual distributions for each of the three costs led us to truncate the mean at the 98th percentile for familiarisation, the 96th percentile for removal and replacement costs and the 98th percentile for removal and replacement costs for companies which are corporate directors. As detailed in the above text, this yielded total costs to business of £39m.

26. We have conducted some sensitivity analysis around our 'best' estimates by using a truncated mean one percentile either side of the central estimate. For instance, for familiarisation our 'high' estimate was £129 (99th percentile truncated mean) and our 'low' estimate was £74 (96th percentile truncated mean).

	Familiarisation (£)	Companies with a corporate director - removal and replacement (£)	Companies which are a corporate director - removal and replacement (£)	Total cost to business (£m)
Mean staff cost	500	769	798	217
Mean staff cost excluding zero responses	814	1079	1124	322
99th percentile - truncated	129	390	257	78
98th percentile - truncated	**96**	235	**139**	48
97th percentile - truncated	74	166	105	35
96th percentile - truncated	60	**132**	84	28
95th percentile - truncated	48	103	64	22
94th percentile - truncated	40	81	53	18
93rd percentile - truncated	34	66	45	15
92nd percentile - truncated	30	56	39	13
91st percentile - truncated	25	48	35	11
90th percentile - truncated	20	42	30	10
89th percentile - truncated	17	37	26	8
88th percentile - truncated	14	33	23	7
87th percentile - truncated	12	30	20	6
86th percentile - truncated	10	26	18	5
85th percentile - truncated	9	24	15	5

Table A3: Truncation of the sample – top percentiles

27. This approach has limitations because we are losing a significant number of observations with corresponding impacts on the standard errors. The trimmed observations will be lost from both the top end of the distribution (where we are truncating based on the percentiles detailed in the table) and from the bottom end (where we have excluded all zero observations). Table 5 details this.

	Number of zero observations	Zero observations as % of all observations	Truncated mean percentile
B3. Costs as a result of company familiarisation with the proposed reforms	67	12%	85th
C2. Costs as a result of identifying and collecting information about the beneficial owner	387	67%	90th
C3. Costs as a result of responding to a request about your beneficial ownership.	185	32%	95th
C4. Costs as a result of collation, process and storage of beneficial owners data	162	28%	94th
C5. Costs as a result of updating beneficial ownership information on an annual basis	119	21%	85th
C7. Costs as a result of providing beneficial ownership information to a central register on an annual basis	76	13%	85th
D1. Costs as a result of ensuring your company is familiar with proposed reforms to prohibit corporate directors	186	32%	98th
D7. Costs as a result of removing and then replacing the corporate director	147	26%	96th
D8. Costs as a result of removing or updating your corporate directorship	165	29%	98th

Table A4: Truncation of the sample – zeros and top percentiles

28. However, the alternative to using the survey data would be to rely on other estimates which are limited in scope, and leave substantial gaps in the evidence base. For this reason, our view is that the only feasible approach is to use the adjusted survey data as discussed above, and we have therefore adopted this approach consistently throughout our analysis.

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