Department for Business, Innovation & Skills

Final Stage Impact Assessments to Part A of the Transparency and Trust Proposals (Companies Transparency)

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Introduction

1. The following document includes the Impact Assessments (IAs) for measures included in Part 7 of the Small Business, Enterprise and Employment (SBEE) Bill ('Companies: Transparency') and selected measures from Parts 8 and 9 which together take forward the Government's *Transparency and Trust* package.

2. These are the Final Stage Impact Assessments for the following measures:
    a. Enhanced Transparency of Company Beneficial Ownership[1]
    b. Prohibiting Bearer Shares in UK Companies
    c. Company directors and opacity of corporate control

Background

3. A lack of transparency and of accountability with respect to those controlling a company can facilitate elicit activity, erode trust and damage the business environment. Ultimately this can hold back economic growth.

4. The UK has put corporate transparency on the international agenda. At the Lough Erne G8 Summit in June 2013, the Prime Minister led the G8 countries in agreeing to a number of core Principles to prevent the misuse of companies and legal arrangements.

5. The Department for Business, Innovation and Skills (BIS) subsequently published the *Transparency and Trust* discussion paper (July 2013). In it we sought views on how to improve corporate transparency and accountability in the UK. This included how best to proceed with the corporate transparency proposals in the UK's 2013 G8 Action Plan, and a range of related measures to improve confidence in the UK's regime for tackling company directors who have engaged in misconduct.

6. On the 21 April 2014 BIS published the Government's response to the views received in relation to the *Transparency and Trust* discussion paper. The response set out how we intended to take forward reform. Provision has accordingly been made in the SBEE Bill, which was introduced into Parliament on 25 June 2014.

Final Stage Impact Assessments

7. The Final Stage IAs included within this document evaluate the benefits and costs of these measures.

8. We published Consultation Stage IAs alongside the Government response in April 2014. These Final Stage IAs reflect the final policy as set out within the Bill and the further analysis we have conducted.

9. To validate and enrich the estimates of the impacts included in the Consultation Stage IAs, we conducted additional research in the form of a further review of alternative sources of data, commissioned a further company survey and sought 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 are included in the Final IAs.

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[1] Provision for the central registry of company beneficial ownership information is referred to in the SBEE Bill as 'a register of people with significant control'.

Title: Transparency & Trust – Enhanced Transparency of Company Beneficial Ownership **IA No: BIS BE022** **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:** Published 25 June 2014 **Stage: Final Stage** **Source of intervention: International** **Type of measure: Primary legislation** **Contact for enquiries:** Joanna Fitch Transparency and Trust Team Tel: 0207 215 6178 Email: Transparencyandtrust@bis.gsi.gov.uk

Summary: Intervention and Options

RPC Opinion: GREEN

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**
-£1088.2m	-£1086.2m	£97.5m	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 can erode trust and damage 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 (or 'people with significant control' over 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 intends to enhance transparency around the ultimate owners and controllers of UK companies. The chosen option implements the UK's G8 commitment to prevent the misuse of companies, specifically to implement a publicly accessible central registry of company beneficial ownership information. It also meets 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)

0) Firstly, we consider the 'Do Nothing' option and conclude that this would not meet the policy objectives.
1) Implementation of a **central registry of company beneficial ownership information**. Although this has higher costs to business and individuals than Option 2, this is our preferred option as it is the most cost effective way of meeting our policy objectives and UK G8 commitments – particularly in terms of delivering benefits to enforcement agencies and wider society through tackling illicit activity.
2) 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 is unlikely to deliver significant benefits in terms of reducing crime through tackling company misuse (as the information provision would be voluntary) or meet the UK's international commitments.

Will the policy be reviewed? It **will be** reviewed, subject to passage of primary legislation, within three years of legislation implementing the new 'check and confirm' provisions 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: 22 June 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 2015	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -1993.1	**High: -782.8**	**Best Estimate: -1088.2**

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	331.55		52.4	**782.78**
High	758.64	1	143.42	**1993.13**
Best Estimate	417.49		77.88	**1088.18**

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

Costs to Government are estimated to be £70k-109k 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 £417.4m set up cost (familiarisation, identification, collation, storage of data and responding to a request for information), and £77.7m 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 as a result of having to report their beneficial ownership status to companies of which they are a beneficial owner, and update this information as it changes. These costs have not been monetised as it is not possible to estimate how many individuals will have to provide the information, nor the level of costs they will incur. There might be an adverse impact on UK investment from increased disclosure and business costs. The police or other relevant agencies might incur additional costs reviewing applications for personal data not to be disclosed on the public record – for example where beneficial owners might come under threat as a result. Additional court costs might also be incurred.

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low	0		0	**0**
High	0	1	0	**0**
Best Estimate	0		0	**0**

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 and increased efficiency by law enforcement agencies, reduced due diligence costs for regulated entities and from these, efficiency and welfare gains to the economy; 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. 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 and assumptions.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			**In scope of OITO?**	**Measure qualifies as**
Costs: 97.5	**Benefits:** 0	**Net:** -97.5	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 2015	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -0.98	High: -0.95	Best Estimate: -0.96

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	0.9			**0.9**
High	1.0	1		**1.0**
Best Estimate	1.0		0	**1.0**

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 £875k is from a previous Companies House information campaign and is meant to be merely indicative of possible cost. There will also be one-off costs of £70k-109k 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 as both the likely take-up rate and the likely effort expended in the collection of data and reporting (including possible external advice bought in) are uncertain.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	0		0	**0**
High	0	1	0	**0**
Best Estimate	0		0	**0**

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

Any benefits derived from this policy change cannot be fully monetised. It is expected that the impact on crime reduction would be considerably lower in this Option, as would the impact on transparency, however this will depend on the level of take-up of voluntary collection and reporting and the consequent behavioural change of companies.

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

Few benefits from reduced crime are expected under this Option, given that a voluntary approach would not fully help to deter, disrupt and penalise criminal activity. There might be some gains from increased vigilance from the publishing of information on the misuse of companies for crime. There might also be some deterrent benefits in terms of individuals choosing to incorporate a company or conduct illicit activity outside the UK, but these are expected to be limited. In addition there might be some increase in transparency which could feed through into more economic transactions. It will not however meet our G8 commitments or international standards. Overall this Option is not likely to achieve the desired objective of the policy fully.

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

BUSINESS ASSESSMENT (Option 2)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs: 1.0	**Benefits:** 0	**Net:** -1.0	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. They agreed common Principles[1] to tackle the misuse of companies and legal arrangements and to publish National Action Plans setting out the concrete steps they would take to implement them. Central to the Principles was that companies should obtain and hold information on their beneficial ownership (i.e. on the individuals who ultimately own and control the company), and that this information should be accessible onshore to relevant authorities. The UK has committed to do this by creating a publicly accessible central registry of company beneficial ownership information, maintained by Companies House[2]. This policy is referred to in the Small Business, Enterprise and Employment (SBEE) Bill as the 'register of people with significant control'.
- 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 reducing crime through enhanced corporate transparency, increased

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

awareness/vigilance of the misuse of companies and the deterrent effect on setting up companies in the UK for illicit purposes, this is not expected to be as significant as Option 1. It will also not meet our G8 commitments or international standards.

Costs and benefits

- **Option 1:** Delivers benefits to Government, individuals and business through a reduction in illicit activities and potentially some 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 significant benefits in terms of a reduction in illicit activities given the voluntary nature of the data provision.
- The costs and benefits described in this Impact Assessment (IA) are based on the most robust and up to date analysis available.

Implementation

- Primary legislation is being taken forward to implement this policy; although some elements will be taken forward through secondary legislation. Once primary and secondary legislation has completed its Parliamentary passage and been commenced, we will look to operationalise the central registry. This will be as soon as practicable after primary and secondary legislation comes into force, taking account of the need to implement system changes at Companies House and communicate the changes to companies.
- 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.
- The SBEE Bill provides for the policy to be reviewed within three years of the legislation implementing the ‘check and confirm’ provisions coming into force. Check and confirm provisions will provide for information on people with significant control to be provided to the registrar of companies (Companies House).

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. They agreed common Principles[3] to tackle the misuse of companies and legal arrangements and to publish national Action Plans setting out the concrete steps they would take to implement them. Central to the Principles was that companies should obtain and hold information on their beneficial ownership (i.e. on the individuals who ultimately own and control the company), and that this information should be accessible onshore to relevant authorities. The UK has committed to do this by creating a publicly accessible central registry of company beneficial ownership information, maintained by Companies House[4].

2. The G8 and UK 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 […][5]."*

3. This Impact Assessment (IA) 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, made in June 2013[6]. Other IAs 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.

4. 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

5. Estimates vary on how much criminal money is generated and laundered within and through the UK. A 2012 EU-sponsored study estimated that about €25bn a year is laundered from UK crime[7]. The Home Office judges that in 2010/11, UK organised crime generated about £13bn, of which they estimate about £10.5bn is laundered. This figure excludes 85% of fraud and other non-organised crime[8]. Furthermore, the social and economic costs of organised crime in the UK are estimated to be £24bn[9], of which £8.9bn are associated with fraud.

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3 G8 action plan principles to prevent the misuse of companies and legal arrangements (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

4 UK action plan to prevent misuse of companies and legal arrangements (June 2013): https://www.gov.uk/government/publications/uk-action-plan-to-prevent-misuse-of-companies-and-legal-arrangements/uk-action-plan-to-prevent-misuse-of-companies-and-legal-arrangements

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

6 UK action plan to prevent misuse of companies and legal arrangements (June 2013): https://www.gov.uk/government/publications/uk-action-plan-to-prevent-misuse-of-companies-and-legal-arrangements

7 Project 'ECOLEF', the Economic and Legal Effectiveness of Anti-Money Laundering and Combating Terrorist Financing Policy (November 2012)

8 Home Office (2013): *Understanding organised crimes: estimating the scale and the social and economic costs*

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

6. Globally, the European Commission's 2013 IA of *Anti-Money Laundering and Terrorist Financing*[10] 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[11]. And 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. The Africa Progress Panel chaired by Kofi Annan[12] 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[13].

7. 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)[14] has observed that: *"almost every economic crime involves the misuse of corporate vehicles [i.e. companies]*." A World Bank review[15] reported that 150 of the 213 grand corruption cases investigated involved the use of at least one corporate vehicle to hide beneficial ownership and the true source of funds; across the study, 24 UK corporate vehicles were found to have been involved (the sixth highest of all countries)[16]. In these 150 cases, the total proceeds of corruption were approximately $56.4bn. Meanwhile, the World Economic Forum (WEF; 2013)[17] 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.

8. 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 G7, 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.

9. UK law enforcement and tax authorities have in addition provided case studies which give an indication of the scope and scale of the misuse of companies. 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. The Serious Fraud Office (SFO) and Metropolitan Police Service (the 'Met') have highlighted a number of cases in which UK and/or overseas-incorporated companies are used to channel illicit funds through the UK; hold UK assets such as property; or perpetuate fraud involving UK citizens. Amounts up to £50m can be involved in such crimes. Recovering the proceeds of such crimes can be incredibly difficult - if not impossible - not least because of the multi-jurisdictional nature of the various companies involved in the ownership chains. Further examples are provided at **Annex D**.

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10 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*

11 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.

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

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

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

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

16 https://star.worldbank.org/star/sites/star/files/puppetmastersv1.pdf page 121

17 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."*

10. These authorities have made a strong case for action to increase corporate transparency. The SFO, the National Crime Agency (NCA)[18], the Crown Prosecution Service, the Attorney General's Office, HMRC and the City of London Police and the Met have been engaged in the development of the *Transparency and Trust* package generally, and this IA 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[19].

11. In the UK, there are currently circumstances in which a company's beneficial owners ('people with significant control') should already be identified. For example, under the UK's anti-money laundering (AML) regime[20], 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 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, which 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 does so to a lesser degree. It is also possible the company may simply give up, with an unquantifiable potential reduction in lawful UK economic activity.

12. 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 prosecute successfully). Law enforcement agencies say the opacity of current beneficial ownership arrangements is a significant barrier to tackling money laundering and successfully recovering stolen assets:

    - **NCA**: 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. The NCA estimated that in around 70% of such investigations issues around beneficial ownership arise. Last year 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.
    - **SFO**: The SFO has stated that establishing the beneficial ownership of assets is almost always a key element of confiscation investigations. They note that at any one time there will be around 50-60 active criminal investigations by the criminal case teams. The Proceeds of Crime Division will also have around 100 individuals under investigation plus around 40 individuals already subject to confiscation orders (where enforcement action is being taken to make them pay what the court has ordered). One case involved a UK company as well as overseas companies, and took a team of four around two years before a confiscation order was obtained.
    - **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] And previously the Serious Organised Crime Agency (SOCA)
[19] Including evidence provided by SOCA prior to the launch of the National Crime Agency in October 2013.
[20] See the Money Laundering Regulations 2007 (No. 2157)

13. Discussions with enforcement agencies and a private sector fraud investigator 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[21]. This necessarily increases the time and cost of obtaining beneficial ownership information, for both UK and international enforcement agencies.

14. 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 may result generally in companies doing less business with the UK. Similarly, without this transparency, where one company wants to identify with whom they are really doing business, they may have to spend more time or resource in obtaining this information, or be more reluctant to engage with the company in the first place.

15. 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."* However, keeping the UK's position secure requires continual evaluation of improvements that can be made.

16. Linked to this is the need to meet relevant international standards on company beneficial ownership transparency in the context of anti-money laundering and counter-terrorist financing. If the UK is not assessed as effectively meeting these standards, it could have an adverse impact on our international reputation and standing. This may in turn have a detrimental effect on the UK's attractiveness and competitiveness.

17. 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

18. 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 negatively impact on economic growth.

(1) Regulatory failure and the potential facilitation of crime

19. 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,

[21] 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*

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.

20. Companies and other corporate entities have separate legal personality, meaning 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. Alongside these advantages, which facilitate entrepreneurship[22], a company is required to put more 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, the use of certain arrangements involving directors) can be used to conceal an individual's interest in a company.

21. This potential for anonymity means the individuals who 'stand behind' the company can then use the company as a front, for example, to launder the proceeds of crime and to finance organised crime and terrorism[23]. A Home Office rapid evidence review (February 2014) concluded that corporate entities can be used to enable or assist criminality, to launder money or to provide prestige or perceived legitimacy. UK enforcement agencies have provided examples of the types of activity that can be facilitated using opaque corporate structures. These include tax crimes such as Missing Trader Intra Community (MTIC) fraud[24]; hiding stolen assets and the proceeds of crime; fraud; and drug and people trafficking.

22. The anonymity afforded by the corporate structure also means 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**.

23. 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[25]. The aim of this policy to address the regulatory failure affecting corporate ownership and transparency of control is to reduce the opportunity for criminal activity and thus reduce these costs to the UK.

24. 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.

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22 Brian Brougham (2011): *Entrepreneur Wealth and the Value of Limited Liability*
23 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.
24 Missing Trader Inter Community (MTIC) fraud contains two elements: a missing trader and an intra-community supply. There are two types of MTIC fraud - acquisition and carousel - as well as one variant - contra trading. For more information go to: http://www.hmrc.gov.uk/manuals/vatfmanual/vatf23300.htm
25 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.

25. 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[26]."*

26. 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)[27] 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[28] 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

27. 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.

28. 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[29]."* 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.

29. However, corporate opacity – created, for example, by a distinction between the legal owners of a company as recorded on the company's register of members and the 'beneficial owners' on whose behalf company shares are held – can nevertheless lead to **two** sub-optimal outcomes.

30. 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.

31. 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. In these cases, an ability to identify the beneficial owner would improve the ability of the shareholders (understood here as the individuals and companies investing in the company, whether

26 UNODC (October 2011): *Estimating illicit financial flows resulting from drug trafficking and other transnational organized crimes: Research report*
27 Goulas and Zervoyianni (2013): *Economic growth and crime: does uncertainty matter.* Applied Economics Letters, Vol 20, issue 5, pp420-427
28 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
29 Hannigan, B (2003): *Company Law*, Clays Ltd

directly or through an intermediary) to hold the company to account, and ultimately drive more successful outcomes.

32. 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)[30], greater shareholder unity enables shareholders to hold companies to account more effectively, which is thought to generate efficiency, corporate profit and therefore economic growth[31]. 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.

33. As noted in the seminal paper by Hirschman (1970)[32], 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.

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

35. 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.

36. Arguably, 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, and therefore their own engagement with them, more accurately. 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 can make economic transactions/activities less attractive[33] and hence less likely to go ahead or they might go ahead but at a higher cost or lower level. For instance, Easley and O'Hara (2004)[34] 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[35].

37. 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[36]. 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.

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

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

32 Hirschman, A. O. (1970) *Exit Voice and Loyalty: Responses to Decline in Firms, Organisation and States* Harvard University Press

33 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.

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

35 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.

36 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.

38. 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[37] 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.

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

40. Opacity could also drive adverse selection[38]. Here 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 business will only go-ahead at a sub-optimal quantity, or not at all. Over time, standard economic theory suggests that less mutually beneficial business 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[39]. On this basis, a lack of transparency and trust can inhibit optimal economic activity.

41. 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[40].

42. 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)[41] finds evidence suggesting 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.

43. 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 who do business with, or invest in, the company and those that control it.

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37 Gigerenzer, Gerd and Selten, Reinhard (2002): Any benefits derived from this policy change cannot be monetised. *Bounded Rationality*. Cambridge: MIT Press.
38 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.
39 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
40 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.
41 Whiteley, P. (2000): *Economic Growth and Social Capital*, Political Studies 48, 443-466.

D. Policy objective

44. 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 will implement reform via primary and secondary 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.

45. 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.

46. Company beneficial ownership reform should, in line with the UK's G8 commitments:

- ensure UK companies obtain and hold adequate, accurate and current information on their beneficial ownership; and
- ensure this information is publicly accessible onshore in a central registry. The registry should provide a single source of information to support national and overseas 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.

47. 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 G7 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.

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

- is effective and proportionate and the most cost effective way to achieve the policy objectives;
- maximises the potential benefits to be gained by UK and overseas enforcement authorities, financial institutions and other regulated professional bodies, and the wider national and international 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

49. 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 UK company. In addition, public companies can use provisions in the Companies Act 2006 to investigate their own membership (i.e. shareholders).

50. 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 applies for around 30 production orders from the courts each year, and this takes some two staff-days per order 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 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 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

51. 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[42]."

    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.

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[42] 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

There are a number of variables as to how a registry could be implemented, and BIS sought views on these options in the *Transparency and Trust* discussion paper.

52. A model, taking account of consultation responses to the *Transparency and Trust* discussion paper, is set out below. Further detail as to the variables that we have now discounted is provided at **Annex D**. The policy model is outlined in further detail in BIS' Government response to the *Transparency and Trust paper* (July 2013). Legislation provision is contained within the SBEE Bill.

53. Ultimately, some elements of the policy will be taken forward through secondary legislation, and we will prepare further IAs as required. This IA considers the costs and benefits of the policy as a whole however.

(1) The definition of beneficial ownership

54. We intend to maintain consistency with the principles of the beneficial ownership definition currently used in AML legislation. The register will hold information on the individuals who ultimately own and control UK companies, whether by directly or indirectly holding more than 25% of the company's shares or voting rights, or by otherwise exercising control over the company or its management. Where more than 25% of a company's shares or voting rights are held in a trust, or where a trust arrangement provides an individual(s) with effective control over the company or its management, the individuals who control the activities of the trust will be recorded as the beneficial owners of the company.

(2) The scope of the registry

55. We intend to require all bodies corporate that currently register information on their members at Companies House to hold their beneficial ownership information and provide it to the central registry. This would include companies and Limited Liability Partnerships.

56. However, we intend to exempt companies with securities listed on a UK regulated or prescribed market from the requirement to maintain this information and provide it to Companies House. This is because these companies already comply with more stringent ownership disclosure rules under Chapter 5 of the Financial Conduct Authority's (FCA) Disclosure and Transparency Rules (DTRs). We also intend to exempt companies with securities listed on a non-UK regulated market subject to equivalent disclosure requirements. Exempt companies will be required to inform Companies House why they are not required to provide beneficial ownership information. We are continuing to consider whether there are non-regulatory ways to increase the transparency of public disclosures made to the market under Chapter 5 of the DTRs.

57. In order to avoid duplicative and burdensome reporting for companies owned by other companies, we intend to provide that where a company (A) is owned by a company (B), and B is exempted from the requirements as set out above, or is a UK company and already maintains a register of beneficial ownership information, company A need only provide relevant details about company B, rather than about B's beneficial owners. This will still allow the full ownership chain of A to be traced but should reduce the costs incurred by A.

(3) How beneficial ownership information is obtained

58. We intend 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.

59. We intend to provide that companies must take reasonable steps to find out if there is anyone with significant control in relation to them and if so, to identify those persons. If a company cannot identify its beneficial ownership, it will be required to state that fact on its register of beneficial owners. Companies will be given a statutory power to make enquiries of persons who they know or

have reasonable cause to believe to be beneficial owners; or who know the identity of the beneficial owners (or the identity of someone with that knowledge).

60. Individuals with a beneficial interest in a company will be obliged to inform companies of their interest in the company. We have carefully considered the interaction between the company's obligation and that of the individual to ensure the process is as efficient as possible. For example, individuals need not so inform the company if they have already been notified by the company of their entry on the company's register of beneficial owners.

(4) Providing and updating information in the central registry

61. Having obtained beneficial ownership information, companies will be required to maintain a register of this information (at their registered office, or other specified location which in future may for some private companies - if they wish - include Companies House) and provide it to Companies House.

62. We intend to require companies to hold information on their beneficial owners' full name, date of birth, nationality, country or state of usual residence, residential address, a contact (or "service") address, the date on which the beneficial owner acquired the beneficial interest (and ceased to hold it, where applicable), and details of the beneficial interest and how it is held. With the exception of residential addresses, this information will be kept available for public inspection by the company.

63. The company will be required to provide this information to Companies House. With the exception of residential addresses and the 'day' of the dates of birth[43], this information will be publicly accessible via Companies House. Residential addresses and the full date of birth will be available to specified public authorities and organisations on request.

64. We recognise concerns around the potential for fraud and other criminal activity through the public disclosure of this information. This would have, amongst other adverse consequences, a cost and time impact on enforcement agencies dealing with the crime. However, we have carefully considered the balance between the information made available publicly and privately; and think that it should limit the risk of fraud whilst ensuring that sufficient information is made available publicly to derive anticipated benefits.

65. We will also put in place an exemptions framework for individuals at risk. This means that their details will be made unavailable for public inspection at the company and Companies House. This information will still be available to specified authorities.

66. We intend to require companies to provide a statement of initial beneficial ownership at incorporation[44]. Thereafter, they will be required to update the register they hold if they know or might reasonably be expected to know that a change to their beneficial ownership has occurred. For example, if 25% of a company's share capital was acquired by a single member of the company, the company should take steps to identify whether the beneficial ownership of those shares had also changed because it might reasonably expect this to be the case.

67. In parallel, we would require beneficial owners to inform the company of any changes to the information held by the company, for example, if they changed their name.

[43] Unless the company has opted to hold its register of beneficial owners at Companies House (for further detail, see the Government response to the *Company Filing Requirements* consultation).

[44] Because the company does not exist prior to incorporation, it can only be a statement of initial beneficial ownership.

68. The company will be required to update beneficial ownership information held by Companies House in the context of the 'check and confirm' process[45]. This means beneficial ownership information held will need to be confirmed and updated with any changes at least once in a 12 month period.

69. Option 1, as outlined above, is our preferred option.

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

70. We have considered the non-regulatory option of a Government-led campaign encouraging companies to obtain, report and have published 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.

71. 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.

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

73. This is our least preferred option.

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

74. 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 representative survey and follow-up survey both using company interviews (see **Annex A** for the methodology). The results from these are used to inform the analysis below.

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

Benefits

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

[45] The 'check and confirm' process will replace the Annual Return. This means that the company will be required to update all relevant information – including beneficial ownership information - at least once in a 12 month period (for further detail, see the Government response to the *Company Filing Requirements* consultation).

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

76. 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 tackle crime by enhancing corporate transparency. It should result in a situation where apprehending criminals is both cheaper and easier for law enforcement agencies. It should also have a deterrent effect (i.e. criminals less likely to misuse UK companies). 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.

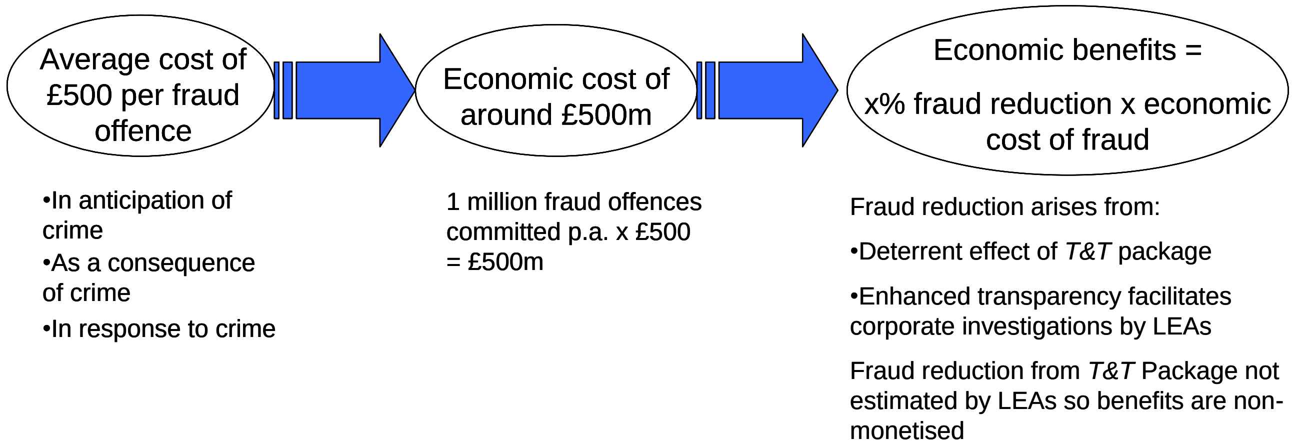

Figure 1: The logic chain behind the benefits of the **Transparency and Trust** ***package***

77. In discussion with UK enforcement agencies, including the NCA (formerly SOCA), the SFO, the Met, the City of London Police, the Crown Prosecution Service, the Attorney General's Office 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).

78. The SFO has commented that the overall *Transparency and Trust* package would *"make UK corporate vehicles less attractive to criminals as a means to commit fraud or facilitate money laundering"*. 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. Whilst much of the criminal activity took place overseas, the UK, due to 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 30-50% of an investigation could be spent identifying the beneficial owners through a chain of ownership.

79. 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 enabling law enforcement agencies to have 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). This is equally the case in respect of overseas authorities, who may need to make fewer formal requests for information to UK authorities as a result of a public register of beneficial ownership. As well as being of benefit to them, we might expect corresponding resource efficiency benefits for UK authorities as they would need to expend less time and effort in responding to these information requests.

80. In 2002 a Government IA[46] on similar proposals (though with real time updates to Companies House on beneficial interests exceeding 3%) was produced. It based its analysis on desk research and interviews with 30 key public and private sector sources. This estimated benefits to the police of £30m in cost savings and improvements in recoveries. Up-rated over the last 11 years, this leads to a benefit of some **£40m** pa.

81. It is not just law enforcement agencies that expect to derive benefits from enhanced transparency around company beneficial ownership. HMRC, for example, has indicated a number of potential benefits to having a central source of beneficial ownership information. Further information on the potential benefits to law enforcement and tax authorities is provided at **Annex D.**

82. Since the opacity of company beneficial ownership facilitates criminals' engagement 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: the successful prosecution of those committing the crime; the deterrent effect of the measures introduced; and/or through the disruption of the criminal activity. For example, if a key member of an organised criminal gang is imprisoned, the activity of the rest of the gang may be restricted or stopped.

83. This benefit 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 the Criminal Justice System, including the police/other criminal investigators).

Total economic cost of fraud

84. On this basis, we have 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 of the policy to society from a reduction in crime, nor the benefits to law enforcement agencies in terms of reduced costs (in part because there is no systematic distillation of the investigation data to identify the impact of a single factor, such as hidden beneficial ownership).

85. 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 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 that there is also the breadth of potential criminal activity linked with financial crime and hence opaque corporate structures.

86. The methodology used places a value on the opportunity cost of resources used:

- in anticipation of crime (e.g. insurance[49] or security expenditure);

[46] HMG (July 2002): *Regulatory Impact Assessment: Disclosure of beneficial ownership of unlisted companies*

[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.

[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. The NERA (2000) crime figures are disaggregated slightly differently to ONS data but we have arrived at a reasonably close match between the two data sources.

[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

- as a consequence of crime (e.g. to the victim); and
- as a response to crime (e.g. to the criminal justice system[50]).

87. 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.

88. We have uprated the average cost estimates for inflation to arrive at estimates in 2013 prices, using standard HMT GDP deflators[51]. We have also removed the cost of benefit fraud which, as a conservative step, could be considered the 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:

		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
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

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

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

89. 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.

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

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

90. 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 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.

91. 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].

92. 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 potential impact of this policy intervention

93. 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, 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 or capability if companies are more transparent. For example, enforcement agencies may be able to match up beneficial ownership data held by Companies House against their own systems and databases to identify trends or patterns highlighting criminal activity. This could in turn have a deterrent effect which could then reduce costs for law enforcement agencies.

94. 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.

95. 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 from implementing the comprehensive package is likely to be greater than the sum of its parts.

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.

The scale of the economic benefits

96. 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:

Reduction in crime	Economic benefit
2% reduction in crime	£10.5m (2% of £523m)
5% reduction in crime	£26.1m (5% of £523m)
10% reduction in crime	£52.3m (10% of £523m)

97. 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 pa falls on the public sector and £270m pa falls on the private sector. The benefit of reducing corporate opacity to reduce this crime would similarly be derived from the reduction in these indicative costs. In this case, for example:

Reduction in crime	Economic benefit
2% reduction in crime	£28.5m (2% of £1,427m)
5% reduction in crime	£71.4m (5% of £1,427m)
10% reduction in crime	£142.7m (10% of £1,427m)

98. Feeding into 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.

99. 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].

100. 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

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.

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

literature[60] does not directly identify the mechanism through which crime affects growth, it has repeatedly been highlighted that reducing crime will support growth.

101. 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 set out in the 'problem under consideration', 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. 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.

102. In addition to benefits to individuals through crime reduction, there will also be benefits to regulated entities[61] who will have more ready access to information on beneficial ownership, either through Companies House, credit reference agencies 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 credit reference agencies[62] have indicated that they may also gain from increased transparency through better risk assessment of companies. Also 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 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.

103. 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.

104. In summary, **there is little quantified data about the benefits resulting from this policy proposal**. However, based on the responses to the discussion document and the focus groups, 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.

[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] 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.

[62] Business Information Providers Association

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

105. 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.

106. In the representative company survey undertaken for BIS by IFF Research only 10% of respondents indicated that the proposed reform would ensure they know with whom they are doing business, thereby 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. As noted by the RPC, this implies that the benefits around increased transparency might in practice be less than set out in the rationale above. We accept this comment and the implication that the non-monetised benefits arising from increased transparency should not be overstated in size.

107. This is however to some extent mitigated by other consultations. In a Focus Group of representative industry bodies, participants recognised the potential benefit to the UK in being seen to have fully met international standards around company beneficial ownership (and the potential adverse impact if the contrary were true). Furthermore, representatives of business information providers highlighted in discussion the potential economic benefits of having company beneficial ownership information in the public domain. They noted their customers (lenders, insurers etc) would be likely to use information of this nature to inform decisions about whether to do business with a company, and on what terms, as it would help build a picture of the company. Providers could look at trends and patterns in the data to improve the quality of their own analysis. In this way they felt that a central registry of company beneficial ownership would have the potential to facilitate or improve the terms of economic transactions.

108. Economic theory suggests 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) although the level of the increase is highly uncertain. Empirical evidence in this area, whilst informative, relates to the general relationship, observed across the economy, rather than beneficial ownership 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; this enables them safely to simplify the contracting process between them[63]. Therefore increased corporate transparency can increase economic growth through the mechanism of increasing trust and reducing transaction costs. A more detailed explanation of the theoretical and empirical framework linking trust, transparency and growth is set out in **Annex D**.

110. 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, could potentially be realised but the level and specific policy causal link are uncertain and hence are unmonetised here.

Costs

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

111. The cost estimates below are based on results from a survey of companies undertaken by IFF Research (2013)[64] (see **Annex A**). The costs identified through the survey have been processed - using statistical techniques and in the light of subsequent discussions/interviews with companies - 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 implausible high values that could make the dataset less robust and the re-coding of zero wage cost values (again, see **Annex A**)[65]. The start date for implementation of the reform is subject to Parliamentary timetabling. However, we do not anticipate that it will be before late 2015.

Corporate entities in scope

112. We intend to require all bodies corporate that currently register information on their members at Companies House to hold their beneficial ownership information and provide it to the central registry. This would include companies and Limited Liability Partnerships.

113. However, we intend to exempt companies with securities listed on a UK regulated or prescribed market from the requirement to maintain this information and provide it to Companies House. We also intend to exempt companies with securities listed on a non-UK regulated market subject to equivalent disclosure requirements. These companies would simply be required to state their exemption in the course of routine information provided to Companies House.

114. 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.

115. The FAME database reports that there are **3.24m UK companies[66]**. This figure includes active and dormant companies, and companies in the process of being dissolved. Of these **3.13m are small or micro companies,** thus the population is highly skewed towards small firms where we might expect the costs to be lower (this a priori judgement accords with results from the survey BIS undertook, as set out in the SaMBA below). Companies House register statistics show that there are around 59,000 Limited Liability Partnerships (LLP) on the 'LLP Total Register'[67] (included in the 3.24m figure above).

116. The proposal exempts companies with securities listed on a UK regulated or prescribed market[68] and those on a non-UK market subject to equivalent disclosure requirements. We would also intend to exempt Limited Partnerships, European Economic Interest Groupings, industrial/provident companies and foreign companies. Applying these exemptions to the FAME population gives an estimated number of companies in scope of **3,185,000**.

117. It is expected that the costs to companies will depend on the number of shareholders but also its size and ownership structure. According to FAME data, out of the 3.19m UK companies, there are **2.96m with fewer 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

64 IFF Research (2013): *Transparency and Trust Company Survey* – Forthcoming

65 Please note: costs have been rounded in this section to avoid spurious accuracy.

66 Company population estimates were extracted from the FAME database (Bureau Van Dijk Electronic Publishing, 2013). This figure includes Limited Liability Partnerships.

67 Companies House (November 2013): *Companies Register Statistics for November 2013*

68 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

with more shareholders. In addition, the table below sets out the number of firms broken down by the complexity of their ownership structure. Ex ante, we also expect those with more layers/more complexity of ownership to face the greatest costs in identifying their beneficial owners.

Complexity of ownership	Number of companies
One or fewer layers of ownership	3,000,000
Two or three layers of ownership	100,000
Four or more layers or foreign ownership	80,000

118. It is worth noting that some companies (A) will be owned by companies (B) that are exempt (e.g. because they are listed), or already maintain a register of beneficial ownership. In such cases, A will only be required to place details of B on its register, rather than details of B's beneficial owners. In such cases we anticipate the costs to A would be lower than would otherwise be the case.

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

C1. Public sector costs

<u>*One-off costs*</u>

a.1. IT development

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

121. Companies House has indicated that they will experience a one-off cost ranging from **£58.5k-£97.5k** (with a mid-point of £78k) for IT development to set up the registry[69]. This will involve collecting and storing beneficial ownership data in new fields and tables within the existing system. It is estimated that it will cost £39k to update the information in the context of the new 'check and confirm' process. Making the information publicly accessible will 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.

a.2. Communication and publication costs

122. 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.

123. It is likely Companies House would use a wide range of cost effective and targeted communications to companies such as including 'inserts' (i.e. an information page in another document) with standard reminders. Companies House has indicated the anticipated costs of sending an insert on *Transparency and Trust* reforms to the 3.19m companies would be minimal, at around £23k. This cost would cover the communication for the corporate directors and opaque arrangements involving company directors part of the package of reforms as well as for beneficial

[69] We expect there to be transition costs to software providers associated with updating their standard packages to reflect the changes in the Transparency and Trust and Company Filing proposals. Software companies provided a single cost estimate for the policy proposals collectively rather than broken down by proposal. Discussion of these cross-cutting costs is included in the Company Filing Requirements validation IA. Therefore we have not included the costs here to avoid double counting.

ownership, thus we have assumed that the £23k would be split evenly between the two policies. Hence the cost for beneficial ownership is **£11.5k.**

124. 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. Given the uncertainty around the specific activities, it has not been possible to estimate a cost here.

125. **The overall monetised one-off costs to the public sector are estimated to be £89.5k (£11.5k + mid-point between £58.5k and £97.5k) with a range of £70k and £109k.**

<u>*Ongoing costs*</u>

a.3. Staff costs to support the registry

126. On the basis that beneficial ownership information will be submitted at incorporation and in the context of the 'check and confirm' process (i.e. at least once in a 12 month period) 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.

127. There will however be ongoing staff costs of approximately **£220k** pa to support the closed system for beneficial owners' residential addresses and full dates of birth, and for all of the information on those beneficial owners who are deemed at risk. This figure is based on the current costs of seven people administrating the (closed) usual residential address system for company directors[70]. If Companies House were to set up a similar system for beneficial ownership, they estimate that the costs would be roughly the same. However the number of applications and the complexity of the final process will ultimately affect the costs to Companies House.

128. Beneficial owners who consider themselves at risk will be able to apply to Companies House for all of their information to be protected from public disclosure. On receipt of an application for information to be protected, it is likely that Companies House may need to confirm the validity of that application with a relevant authority, such as the police. There would be costs to those authorities in providing that advice/confirmation but we do not know how long this might take or how much it might cost. We also do not know how many applications to Companies House for information to be protected there might be. As an indication, in the last financial year there were around 500 applications to Companies House for information to be suppressed on the public register or not provided to Credit Reference Agencies. We might however anticipate more applications in the context of beneficial ownership.

129. Following standard IA methodology, this IA 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).

130. **The total Net Present Value monetised costs to the public sector are therefore expected to be £1.98m over 10 years[71].** 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. Companies House have noted that, based on the current level of information, they do not anticipate higher fees to companies as a result of this proposal.

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[70] Company directors are required to provide a usual residential address and a service address to Companies House. The former is not available for public inspection, other than to specified authorities and Credit Reference Agencies and is maintained on a closed system. Currently an individual or company may apply to the Registrar of Companies to make an address unavailable for public inspection (£55 per document to be suppressed); or to make usual residential address information unavailable to a Credit Reference Agency (£100 per application).

[71] 10 years is the expected life of the policy and the NPV uses standard Green Book discount rates.

C2. Private business costs

131. 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. The RPC asked for clarification on the sources of data used in the consultation IA and for sensitivity analysis using alternative sources. The analysis in this final IA uses results from a one-off bespoke representative company survey commissioned by BIS but validated/informed by other sources as set out below (**Annex A** provides more detail on the methodology used and **Annex C** provides some sensitivity analysis on the key assumptions).

132. 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.

133. A 2013 report for Global Witness by J Howell & Co Ltd[72], based on a 2002 government RIA, 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. We have considered this report, and its findings, carefully. However, the approach is largely based on assumptions and expert opinion, rather than direct engagement with the business community. The assumptions used may not therefore reflect the actual cost to companies (e.g. the cost of collating and processing the relevant information). In addition, the research does not fully consider familiarisation costs, which we would expect to form a significant proportion of the total cost to companies, nor the cost of identifying the beneficial owner.

134. BIS also undertook an online non-representative company survey as part of the consultation process for the proposed measures. 32 responses were received. 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 operating costs.

135. A sample of published IAs was analysed but provided little relevant cost information for this specific proposal. For example, the most closely related assessment was made for the Anti-Money Laundering IA[73]. This notes that complying with the requirements for newly obligated entities would cost 0.16%-0.29% of operating expenses (though it offers no specific monetised cost estimates). It also noted that additional beneficial ownership information requirements are not expected to entail significant burdens to individual companies but that, because a large number of entities would be affected, there would be significant cumulative impact. The Companies Act 2006 evaluation[74] provided estimates of costs associated with **all** the changes for the Companies Act – both internal wage costs and additional costs of external advice. Time spent internally over three years ranged from 0 to 40 hours; external professional services were bought in by only 52% of companies; 64% of

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

[73] Impact assessment on the prevention of the use of the financial system for the purpose of money-laundering, including terrorist financing, 2013

[74] http://www.bis.gov.uk/assets/biscore/business-law/docs/e/10-1360-evaluation-companies-act-2006-volume-1.pdf

those reporting purchasing external services incurred under £500 of costs and 32% did not know the cost. The total cost of all the Companies Act changes is estimated at £1.11bn pa[75].

136. 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. 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)[76] to be £10.73 per company, which uprated to 2013 prices is £12.39.

137. The different sources of information gathered and the results are presented in the table below:

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

Table 2: Comparison of data sources

138. Given the limited, but wide-ranging estimates available on the costs, we felt there was not sufficient information to make an assessment of the costs and benefits of the proposal. Thus BIS commissioned an independent representative survey of companies, undertaken by IFF Research (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.

139. 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.

140. 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**, uprated for non-wage costs, taken from the Annual Survey of Hours and Earnings (as set out in **Annex A**). Estimates of additional costs, such as the cost of external advice, were also provided.

141. Survey responses were collated 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).

142. 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

[75] Our calculations based on the data provided in the Companies Act 2006 Evaluation (which did not formally calculate a total cost to business) gave a total cost per company of £343 p.a. in 2010 prices, which includes both additional costs and wage costs. This gave a total cost of £1.11bn p.a. To arrive at this we used a total company population of 3,238,890; a director's wage of £48.36 taken from ASHE data as above (and transformed into 2010 prices (£46.58) using the GDP deflator); and we used a mid-point of the categories displayed for compliance time and for total cost of external services

[76] 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.

each of the cells, sometimes in contrast to the majority who estimated zero costs. In the light of the range of responses and methodological issues, we undertook further evidence gathering. We held two additional focus groups and commissioned further in-depth interviews with a number of the respondents to the survey. In the former case the intention was to validate or otherwise the cost estimates presented in the consultation IA: in the latter it was to understand better what underpinned the cost estimates. The numbers below used to calculate the costs are based on the results of the first survey adjusted in the light of the focus groups and the second survey (**Annex A** includes the details of the new survey and the processing made to the results of the first survey).

143. In summary we made two statistical changes to the data from the first survey:

- we removed extreme values for each of the questions; and
- we re-coded responses with zero costs.

144. The aim of these changes was to apply standard statistical techniques to adjust for extreme values/outliers and to remove/adjust results which appeared implausible based on our consultations with stakeholders. That is, we adjusted both extreme values and zero costs for all relevant questions. Similarly to the consultation IA, we used a truncated mean for each survey question. For the zero costs, an assumption is made that the proposal will have a cost to all companies (e.g. understanding what the new regulations mean for them).

145. The survey also provided estimates of the additional costs companies said that they would incur when accessing professional (external) advice, e.g. from lawyers and accountants. We did not adjust the zero values received as the results of the follow-up survey showed that where companies had said there was no cost in the first survey they confirmed their view in the second. However, two adjustments were made to the raw data. The first adjustment here was that the extreme high values/outliers were removed, as above. Secondly whilst we included the one-off additional costs we did not include the additional costs for ongoing activities. This was done for a number of reasons:

- A priori it was expected that legal/accountancy advice would be used for:
  - **Familiarisation** – for companies to ensure that they knew what they needed to do to meet their legal obligation
  - **Identifying** the beneficial owners **–** to ensure that the communication would enable them to meet the requirements
  - **Collation and storage –** to ensure that the sensitive/personal data was stored correctly and potentially alongside accounting/other ‘check and confirm’ information
  - **Responding** to a request for information – again to make sure that the request was valid and that the response would ensure that the company was complying with the legal requirement

- However we considered that ongoing advice was less likely to be required when:
  - **Updating** information **–** as the system would already be set up and it then is a matter of just data inputting
  - **Reporting** to Companies House – again this is a part of a standard process unlikely to require both in-house resources and external advice. However, it should be noted that some companies have an ongoing relationship with a Trust and Company Service Provider (TCSP) (including Company Registration Agents, accountants and legal firms) to provide services such as completing Annual Returns. In these cases a company might use one of these organisations to undertake the work for them, but again it would not be in addition to in-house resources (this is considered in the sensitivity analysis in **Annex C**)

146. As part of the follow-up survey we asked companies to review their answers to the questions about additional costs. Generally, the second survey indicated there were differences in

interpretation of the questions on additional costs across respondents. Some companies indicated their estimates were a worst case, others they would actually not incur any costs and still others noted there was some double counting between wage costs and additional costs.

147. On the question of one-off additional costs for beneficial ownership, IFF Research indicate that the results showed that "on the whole" companies said the costs provided in the initial survey sounded about right.

148. On the question of ongoing costs, some companies felt the (low) costs reported in the first survey were about right. However at the higher end of the costs IFF Research indicate that *"they felt that they would not need to incur legal fees"*. Companies from the research commented:

- *"I think that the most likely outcome is that the cost will be neglible... we are only talking about internal time."*
- *"Hopefully I would not consider external advice as we now know where the data is and how to access it."*
- *"I wouldn't normally get legal advice unless I felt that it was something I didn't really understand."*

149. Furthermore our view was that the policy design – of the reporting being included as part of the new 'check and confirm' process[77], the simple updating of existing records/forms and guidance being provided – would mean ongoing additional advice would not usually be required in addition to ongoing in-house wage costs. In the follow-up survey IFF Research reported that, while half of the companies felt that familiarisation cost would still be the same in the light of the new information on policy implementation, a quarter thought that the costs would go down and a further quarter felt that the cost would be higher: for complying with the requirements, respondents either felt that costs would stay the same or fall. There is also the consideration that, if it were required, it could rapidly decay (and hence the annual cost would not be incurred throughout the 10 year appraisal period at the same level). The issue of additional costs is revisited in the sensitivity analysis (**Annex C**).

150. In conclusion, we have included additional one-off costs only in the base case and we have taken the charge/fee as the opportunity cost to the economy of the external advice.

151. The subsequent focus groups that we set up reconsidered the costs presented in the consultation IA. These were largely validated by the groups and, although the attendees found it difficult to place an accurate figure on how much it would cost them to follow a certain procedure, in general they thought our estimates seemed to be reasonable for small simple companies (around 94% of the population) but costs could be considerably higher for larger and more complex companies. Given that the figure was already weighted by the size and complexity of the company, we considered it to be consistent with the types of comments the groups made. The figures presented here resulting from the revised statistical adjustment broadly accord with those presented in the consultation IA.

152. These approaches aim to ensure any data considered is as robust as it can be. **Annex A** provides further information on each of the adjustments and **Annex C** provides the sensitivity analysis on key assumptions. The results of this process are given below.

[77] See Government response to the Company Filing Requirements consultation. The 'check and confirm' process will replace the Annual Return.

	Best estimate - Adjusted mean wage costs per company £	Best estimate - Adjusted mean additional costs per company £*
One-off costs		
Familiarisation costs	55.9	35.6
Identification and collection**	4.3	9.1
Collation, processing and storage	13.2	11.7
Sub – total average one-off cost	***73.4***	***56.3***
Responding to request (only for companies which hold more than 25% shares/voting rights or some other form of control over other companies)	10.7	19.4
Ongoing costs		
Annually update own records***	11	
Report to Companies House annually****	13.4	

Table 3: Breakdown of costs to businesses – wage costs and additional costs associated with obtaining external advice

**Additional cost are only included for one-off costs. It is assumed that there will not be any ongoing additional costs (see above for explanation).*
***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 (we have not been able to monetise the costs for the individual beneficial owners as we do not know how many there are nor what costs they will be incurring as they will not be replicating the actions of the companies[78]. Also see text below for further explanation).*
****The policy will require companies to update their own records as they are made aware of changes by the beneficial owner or where they know or have cause to believe that a change has occurred. The changes, due to their nature, are assumed to take place less than once a year (see below for further explanation).*
*****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 and this may therefore have impacted the responses provided. The proposal is that the information would form part of the new 'check and confirm' process, thus the costs estimated here might be overestimates.*

153. The table above 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 cost that will only apply to a limited number of companies (see below).

One-off costs

154. 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 sensitive/personal data**, i.e. the initial set up costs, have a best cost estimate of **£413.4m** for all companies.

This best estimate is derived as follows: (£73.4 + £56.3) *3.185m, where 3.185m is taken as the total number of UK companies in scope.

[78] The company, when trying to identify its beneficial owners, will need to give notice to the beneficial owners, and potentially approach a number of companies/individuals across a number of layers of ownership and chase up non-respondents. The individual having to provide information proactively, apart from familiarisation, is likely to incur just the cost of producing an email. The two types of activity are not synonymous and hence the costs incurred will be different.

155. The RPC asked for more informed sensitivity analysis on the central estimates. Sensitivity around this figure to provide high and low estimates is based on the statistical treatment of the survey results based on the coefficient of variation and its use in the degree of truncation to arrive at a mean. These in turn are informed by the second survey and focus groups results (see **Annex A**). Here the range for one-off costs is between £328.6m to £749.2m.

156. The cost to companies of identifying and collating data on beneficial owners has been reduced from the initial survey results given that a legal disclosure obligation will also be placed on the beneficial owner to inform the company of their interest in the company (the survey questions explicitly assumed the obligation would be solely on the company). This means the company itself will only be required to take reasonable steps to obtain information proactively on its beneficial owners. This as opposed to identifying all beneficial owners in all cases. We judge that the costs to companies will be lower as a result, and this is supported by the follow-up company survey. In the light of knowing some beneficial owners would provide information proactively, companies said:

- *"Those times and costs would go down considerably. Down by 90%, because all the work's done for you. They're just saying "we're here, hi.""*
- *"Go down by 25% [...] because we would only have to do it for one shareholder and not three."*

157. Lacking any further evidence, we have used a best estimate of 50% and sensitivity analysis is carried out on this assumption (see **Annex C**).

158. In addition to these costs there is also the cost of processing and collecting the data and responding to requests from other companies. Some companies (A) will be wholly or partially owned by other companies (B). B may be required to respond to a request for A for information (either on its beneficial owners; or to confirm that it is exempt or already maintaining a register of beneficial ownership). In other cases A may simply check the central registry to find out if B is exempt or already maintaining a register (and so no action from B will be required). We do not have data on how many companies will receive requests from other companies for information.

159. Whilst we cannot specifically say how many firms will need to respond to a request, the FAME database indicates that there are around 130,000 UK companies that have 335,000 subsidiaries[79], i.e. 130,000 'parent companies'. These parent companies might need to be approached by their subsidiaries in the process of determining beneficial ownership and thus we use this as a proxy. The adjusted mean from the survey of the costs of responding to requests for information is £30.1 (£10.7+19.4) per company, including one-off additional costs of external advice. We have assumed the parent will only incur these costs once, rather than for every subsidiary. This is on the basis that: not every subsidiary will approach their parent (as the subsidiary will have the parent's information on their own share registry); once the information has been gathered once by the parent, the costs of resending the information would be minimal; and we expect the additional cost (for external legal advice) to be incurred only for the first request. Thus the best estimate cost of this element of the proposal is **£3.9m** (ie £30.1 * 130,000)[80]. Again the range around this number is provided by the statistical adjustment of the mean and is £2.9m-£9.4m (see **Annex A**).

160. Where a company wants information on its beneficial owners to be withheld from the public record (e.g. possibly in the case of animal testing companies and domestic violence refuges) the intention is that they would write to Companies House and request this information is protected from disclosure. There will be some cost associated with this, however, we have no evidence as to the

[79] With shareholdings of more 25% in a company.

[80] For ongoing changes to beneficial owners' information, it is expected that the beneficial owners themselves will tell the companies direct, rather than simply telling the parent company who then tells the subsidiaries.

possible number of these companies. The intention is to revisit this aspect of the policy in secondary legislation when a further IA on this would be provided.

161. **The overall monetised one-off costs are therefore estimated to be £417.4m, within a range of £331.5m to £758.5m.**

Ongoing costs

162. Costs on an ongoing basis are also incurred. This analysis is conducted on the basis that companies will be required to check and confirm beneficial ownership information held by Companies House once in every 12 month period (under the new 'check and confirm' system[81]). Companies would be required to update information held in their register of beneficial owners if they know or might be expected to know (i.e. because a 30% shareholding has been sold) that a change has occurred. 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).

163. 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[82]; and changes by Deed Poll – approximately 40,000 pa). Neither do we expect the date of birth to change or nationality to change frequently. Thus, the updates companies are likely to receive on an ongoing basis are expected to relate only to changes of address (though not country of residence) or transfers of ownership.

164. The number of beneficial owners is currently unknown. Companies House indicate that 1.5m companies have one shareholder and 2.96m have fewer than four shareholders. It is plausible that on average companies will have two shareholders. If we assume that the number of shareholders is a proxy[83] for the number of beneficial owners then on average companies might have two beneficial owners. However, some companies will not have any beneficial owners and others might have more than three, e.g. where the beneficial owners are acting jointly to own or control the company. Furthermore some individuals will be beneficial owners of more than one company. On this basis it is not possible to estimate reliably the number of beneficial owners, however, to provide an estimate for the cost to business we assume here that there are two per company. **Annex C** contains sensitivity analysis on this point.

165. On average the ONS's publication *Social Trends* indicates that people move about every 10 years (probability of 1/10). We assume that this will be the case for a service address also. 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 two beneficial owners might have to change the details they hold on **average 0.8 times a year** (i.e. the probability of moving either address (1/10 plus 1/10) + the probability of changing non-trade equities (2/10) for each beneficial owner * 2 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 0.8 times a year might be an overestimate. **Annex C** reviews these assumptions in the sensitivity analysis.

166. From the above Table 3, the companies' **annual update of beneficial ownership data and the annual return to Companies House** are estimated to cost **£77.7m** ((£11+13.4)*3.185m) reflecting the adjusted mean, with a range of **£52.2m to £143.2m** reflecting high and low estimates based on the statistical treatment of the survey results based on the coefficient of variation and its

[81] Note that this does not mean that the company has to verify the data, merely confirm it accords with its own records.
[82] ONS (2011): *Marriages in England and Wales (provisional)*, The Guardian, 7th March 2013
[83] The number of legal shareholders is not synonymous with beneficial owners, however, robust data on the latter is not available.

use in the degree of truncation to arrive at a mean. These in turn are informed by the second survey and focus groups results (see **Annex A**).

167. **The overall Net Present Value of costs expected to be incurred by companies equals £1.086bn over a 10 year period[84]. The EANCB is estimated to be £97.5m pa.**

168. The table below sets out the unit costs, the total cost and the EANCB:

	Total best cost per company	Total cost	EANCB
One-off costs			
Familiarisation costs	£91.5	£291.5m	£26.2m
Identification and collection	£13.4	£42.7m	£3.8m
Collation, processing and storage	£24.9	£79.3m	£7.1m
Sub – total average one-off cost	**£129.8**	**£413.5m**	**£37.1m**
Responding to request (only for parent companies)	£30.1	£3.9m	£0.4m
Ongoing costs			
Annually update own records	£11	£35m pa	£27m
Report to Companies House annually	£13.4	£42.7m pa	£33m
Sub-total – average ongoing cost	**£24.4**	**£77.7m**	**£60m**

Caveats with the survey results

169. 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 some previous cost estimates[85] - in particular familiarisation costs.

170. **Annex A** provides detail on these concerns and how results have been adjusted for the purpose of this final IA.

C3. Individuals

171. As outlined above, there is currently no information on beneficial owners. Thus 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.

172. There are broadly in effect two types of beneficial owner – (i) those with a direct interest of more than 25% of shares/voting rights and (ii) those who otherwise exercise control over the company or have a cumulative and/or indirect interest in more than 25% of shares/voting rights (including by acting jointly with others). The former will be required to read and respond to the request for information from the company and update the company with relevant changes to their circumstances. It is more likely that the latter will need to inform the company proactively that they are the beneficial owner and update the company when their relevant circumstances change.

173. For beneficial owners who are also directors of the company the familiarisation would be unnecessary (as they are likely to have done this anyway in their role in the company – costed out

[84] 10 years is the expected life of the policy and the NPV uses standard Green Book compliant inflation and discount rates.
[85] For example, the analysis conducted by John Howell & Co. Ltd. (April 2013): *Costs of Beneficial Ownership Declarations.*

above in the business section). Also the company will have/will receive (almost all of) the required personal information anyway (apart from information as to how the individual holds their ownership or control of the company, although we might assume that for a company director this would be self-explanatory) as the director is required to provide it already. Furthermore, for small companies with simple structures the person obligated to gather the data is likely to be the same person obligated to respond and provide updated information, thus the additional individual's costs will be neglible.

174. Where the beneficial owner is not a director some costs are likely to be incurred. There might be familiarisation costs for those that will need to provide their information proactively. They might also require legal advice. For those that receive a request for information there will be costs around understanding what is being asked and why. Some individuals will be beneficial owners of more than one company and thus will not require this for every company. It is possible that, in terms of actually providing the information in the first place and updating it with change of address etc, an email is likely to be a typical low cost action[86].

175. Where the beneficial owner is also a shareholder, some of the information will already be required to be provided to the company and updated, though not all will (e.g. date of birth and nationality).

176. 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 serious risk as a result of public disclosure, we intend to allow them to apply to protect their information from public disclosure. We do not therefore anticipate any significant cost in terms of an impact on individuals' well-being through lost anonymity. However, there would be some cost in terms of applying to Companies House for an exemption, as is the policy intention. We do not know how many applications to Companies House there might be. As an indication, in the last financial year there were around 500 applications to Companies House for information to be suppressed on the public register or not provided to Credit Reference Agencies. We might however anticipate more applications in the context of beneficial ownership. The current cost of an application to Companies House by a company/individual to protect information from disclosure is either £55 or £100. We might expect costs for beneficial ownership information to fall within a similar range. This element of the policy will however be set out in secondary legislation, and we will provide a further IA as required.

177. On the basis of the above there is not sufficient information on the likely costs to individuals to present a robust estimate. However, the one-off and ongoing cost of providing information is likely to be low (e.g. an email). The one-off familiarisation cost for those beneficial owners operating jointly to own or control the company and the one-off costs around 'understanding the request' may be more significant.

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

Benefits

178. The benefits of Option 2 are expected to be primarily associated with increased economic activity arising from increased transparency rather than crime reduction, though in the light of the RPC comments, we consider the possible reduction in crime below.

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[86] The company, when trying to identify its beneficial owners, will need to give notice to the beneficial owner, and potentially approach a number of companies/individuals across a number of layers of ownership and chase up non-respondents. For the individual having to provide information proactively, apart from the familiarisation, is likely to incur just the cost of producing an email. The two types of activity are not synonymous and hence the costs incurred will be different.

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

179. Unlike under Option 1, we would not expect to see significant benefits associated with a reduction in illicit activity as the information provided would be merely voluntary.

180. There are non-regulatory techniques for crime prevention and reduction, as outlined in the Home Office's *Serious and Organised Crime Strategy*[87]. For example, education and communications strategies raise awareness of the impacts of serious and organised crime.

181. 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.

182. We therefore anticipate that a non-regulatory approach would not significantly 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.

183. 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 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). Of greater likely impact would be the increased awareness/vigilance of the misuse of companies as this might lead to some reduction in crime.

184. 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.

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

185. 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. Thus could be expected to contribute to enhanced trust in the business environment and potentially facilitating economic growth.

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

186. 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[88]. 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. 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.

187. However, 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). Just a voluntary campaign seems unlikely to be the most effective way to ensure that the benefits of enhanced corporate transparency are universally realised.

188. 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.

Costs

Corporate entities in scope

189. 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

190. 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 the voluntarily provided beneficial ownership information and make it available. Companies might have a choice whether to provide this information, for example, as part of the 'check and confirm' process or by a separate notice. It is assumed that there would be no ongoing costs as there would not be 'at risk' beneficial owners identified; and therefore no closed beneficial ownership register to administer. Thus the one-off costs would be **£89.5k** (with a range of £70k to £109k).

191. Companies House operates as a Trading Fund and would need to recover the costs of these services. For statutory activities they do this by charging fees. Companies House have noted that, based on the current level of information, they do not anticipate higher fees to companies as a result of this proposal.

192. There would be further costs to the public sector associated with promoting the voluntary approach, for example, communications campaigns and business engagement. It is difficult to estimate the cost here given the range of possible campaigns; however, Companies House undertook a campaign to publicise the new Companies Act 2006 and its introduction in 2009, which cost Companies House £800k. The 2009 changes were broader in scope than the current package,

[88] 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

including accounts and audit for instance, though they related to a smaller number of companies than are on the register at present[89]. We have assumed a similar cost might be incurred in this policy proposal (i.e. £875k uprated to 2013 costs).

C2. Private business and individual costs

193. Option 2 would provide no new regulatory costs to business or individuals. Companies and individuals 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 or individual outweigh the costs.

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

194. We believe that the analytical approach taken in this IA 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.

195. 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.

196. Prior to the launch of the *Transparency and Trust* paper, and both during and after the G8 process, we carried out a number of discussions with industry, NGOs and regulated bodies. During the consultation on the *Transparency and Trust* paper, which fed into the evidence base underlying this IA, we:

- consulted with the Economic and Social Research Council;
- consulted with Companies House;
- undertook 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**).

197. After the publication of the *Transparency and Trust* discussion paper, we undertook a further series of focus groups as well as a follow-up survey which revisited some of the respondents to the first survey to understand better the initial responses we received. The evidence gathered from stakeholders has continued 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.

198. For the purposes of the final IA, in particular we built on the existing evidence base with the following:

- an extension to the company survey, consisting of largely qualitative questions;
- a series of focus groups consisting of businesses and trade associations; and
- further discussions with law enforcement agencies and tax authorities.

The company survey was used to inform the way we treated the data collected in the original survey through a series of in-depth interviews with respondents (the methodology and its implications are

89 Based on the Companies House Annual Report of 2012/13: http://www.companieshouse.gov.uk/about/pdf/companiesRegActivities2012_2013.pdf

explained fully in **Annex A**). The focus groups were used largely to validate the estimates we produced in the consultation IA. Discussions with enforcement authorities provided further evidence on the scale of the problem and the potential benefits of reform.

199. 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.

200. 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 or the increased efficiency and efficacy of investigations and prosecutions resulting from *Transparency and Trust* measures, we could go no further to monetise them.

201. The evidence we have gathered to inform cost estimates in this IA 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 IA. However, to gain a better grasp of how to treat these data we undertook a follow-up survey, which helped us identify where it was reasonable to truncate the data and it largely validated the estimates and approach we used in the consultation IA (see **Annex A**).

202. We also held a number of business focus groups, which discussed the likely costs of the proposed reforms related to beneficial ownership, corporate directors and opaque arrangements involving company directors[90]. Largely the companies present agreed with our cost estimates, particularly for small companies (though some said that for small companies the costs might be lower). However, many companies did comment that compliance could cost considerably more for large and more complex companies if legal and accountancy costs were required. Nonetheless, given that our estimates were weighted by the population, which is 98% small companies, this would bring the estimated costs down so the focus groups broadly validated the figures we presented to them.

203. We are satisfied that the evidence presented here represents the most comprehensive and robust assessment available for a final IA within the constraints of proportionality with respect to both cost and time.

Cost / Benefit	**Evidence / Data Gap**	**Use of evidence or 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	• Lack of evidence in the academic literature. • During the consultation, none of the respondents were able to provide quantified evidence in this area. This

[90] Please see Annex B for the attendance list.

	laundering	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*[91]*."* • 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 and Tax Authorities (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	• Adjusted means from the company survey with IFF Research included. • Estimate from Companies House included.
Compliance costs	(i) Separate cost estimates for each of the steps involved in identifying, collating and reporting beneficial ownership data (ii) Compliance costs to individuals	• Adjusted means from company survey with IFF Research included. • Unknown number of beneficial owners or costs they are likely to incur.
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	• Very difficult to predict the level of investment diverted or increased due to mutually beneficial business taking place and to associate this investment with the disclosure of beneficial ownership.

91 Financial Action Task Force: Money Laundering FAQ

	the UK's integrity	

Table 4: Impact Assessment proportionality analysis

H. Risks and assumptions

204. As noted above, we have not been able to gather evidence on the number of beneficial owners and as such have made an assumption about this in relation to the costs to companies in updating their information. In addition to this lack of evidence on the number of beneficial owners, we have not been able to calculate the cost to potential individuals affected. **Annex C** sets out some possible ranges but these are merely indicative. There is a risk that a large number of individuals might be affected, however a priori the cost per individual is likely to be low (with some spending time on one-off familiarisation/understanding of the requirements and more sending (emailing) necessary information). This mirrors the analysis on the costs to business where the average cost per company per year is low (on an EANCB basis the cost is around £30 per year).

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

206. 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 IA, 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.

207. We have and will continue to work closely with law enforcement and tax authorities 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.

208. 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 G7, G20, FATF and in Europe to encourage other jurisdictions to take similar action.

209. 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 have sought to address these concerns through policy development where appropriate and 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.

210. The theory and evidence suggests that the *Transparency and Trust* package could 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 here opacity of company beneficial ownership, is limited. 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.

211. 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 3.19m UK active and dormant companies[92]; and
- our costs estimates are largely based on figures derived from an externally contracted representative survey of almost 600 companies, undertaken by IFF research, and enhanced by a follow-up survey and focus group (see **Annex A**).

212. 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.'

213. 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[93]".* 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[94]."* These issues might well be relevant for non-listed companies also.

214. 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.

215. 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).

216. Moreover, in considering these issues, we should weigh any potential deterrent of investment arising from transparency against the reduced information asymmetry between principals and agents leading to more optimal investment and increasing mutually beneficial business, and a potential increase in the UK's integrity and international reputation as a place to do business and invest. It is

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

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

[94] 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

not possible, however, to place a monetary value on either any lost investment or any possible increase. We do 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.

217. 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 G7, 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.

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

218. The measures in this IA implement international commitments the UK made at the 2013 G8 Summit.

219. We understand that the Better Regulation Framework Manual at time of writing sets out that measures to implement international commitments and obligations are out of scope of One In Two Out (OITO) but, where there is a clearly prescribed minimum requirement or standard and the UK is implementing in a way that goes beyond this, that the additional burden over and above the minimum, would be treated as in scope.

220. The G7[95] is an international forum that brings together seven global leaders (Canada, France, Germany, Italy, Japan, UK and USA, alongside the EU) to address international issues and tackle the most pressing global challenges. The UK held the 2013 Presidency, and the Prime Minister hosted the annual Summit at Lough Erne in June of that year, where the agreements and commitments made by G8 leaders were set out in a formal Communiqué and documentation.

221. At the 2013 Summit all G8 members agreed a set of Action Plan Principles to prevent the misuse of companies and legal arrangements, and to publish Action Plans setting out the concrete action they would take to implement those Principles. All G8 members published an Action Plan and are moving ahead with implementation.

222. The *Transparency and Trust* measures are drawn from the UK's Action Plan commitments drawn from the Action Plan Principles. Strong action to deliver reform that fully meets these commitments is now the minimum the UK must deliver to meet its international obligations.

223. The G8 obligations are binding in that the UK Government has made a public commitment to implement them; they are politically binding but not legally (or otherwise) binding. The G8 will hold the UK and other members to account in the following ways:

- 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;
- 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

[95] Prior to 2013, the G8, including Russia.

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; and

- 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.

224. Failure to deliver against the 2013 G8 commitments would have significant impact on the UK's international standing within the G7 and more broadly, and would create substantial political embarrassment for the Government. However, the forum of the G7 does not set any minimum legal or other standard for implementation, so we judge these measures to be out of scope for OITO.

225. The UK must now act to deliver against its commitments, consistent with and directly relating to the commitments made in the 2013 G8 documentation. As mentioned, every G8 country has committed to an Action Plan, which sets out how they individually plan to take forward a set of Action Plan Principles agreed by all the G8 Leaders, and indeed reflecting the Communiqué.

226. We consider that the measures the UK will take forward are consistent with and directly in response to the commitments the UK has made. The G8 Action Plan Principles are set out below (though only the relevant provisions have been included). Alongside this the UK has set out a UK Action Plan (also below) to deliver the G8 Action Plan Principles. The UK's delivery of the 2013 G8 commitments will be judged against both of these plans.

227. The UK intends to:

- create and maintain a publicly accessible central registry of company beneficial ownership information; introduce sanctions to individuals and companies that fail to comply; and ensure that this information is readily available to national and international enforcement authorities. This is required to deliver points 1, 2, 7 & 8 of the G8 Action Plan Principles and points 2, 3 & 9 of the UK Action Plan;
- remove the right to issue bearer shares and implement transitional arrangements to remove bearer shares from circulation. This is required to deliver point 5 and support the full implementation of point 1 of the G8 Action Plan Principles and points 2 & 7 of the UK Action Plan; and
- restrict the use of opaque arrangements involving company directors. This is required to deliver point 5 and support the full implementation of point 1 of the G8 Action Plan Principles and point 7 of the UK Action Plan.

228. The UK is leading the developments in this area in order to persuade international adoption of these principles and methods. This is required to deliver point 8 of the G8 Action Plan Principles and point 8 & 9 of the UK Action Plan.

229. Points 3, 4 & 6 of the G8 Action Plan Principles and points 1, 4, 5 & 6 of the UK Action Plan are not directly related to corporate transparency and trust and are therefore being taken forward by other parts of Government, most notably HMT.

230. We consider the measures set out here are the minimum measures necessary to comply with the commitments set out in the G8 Action Plan Principles and UK Action Plan. These measures as a package are required to deliver all the G8 and UK Action Plan requirements on corporate transparency and trust.

231. The measures will be implemented in a way to minimise the additional costs to business. Extensive consultation with business and other interested parties has been conducted to ensure that the measures are implemented in the most effective way, without placing unnecessary additional costs on business.

232. We have carefully considered better regulation principles in developing these measures to implement the UK's international commitments, in accordance with good practice and the Better Regulation Framework Manual. This has included consideration of alternatives to regulation and attempts to minimise the costs to business while ensuring the efficacy of the policy interventions. The evidence underpinning these attempts to evaluate and minimise the costs to business is covered elsewhere in this IA.

233. Although, we consider that these measures are not within the scope of OITO, we have, in the interests of good practice, calculated that the preferred option for the beneficial ownership proposal has a net direct cost to business per year of £97.5m.

A. G8 Action Plan Principles to prevent the misuse of companies and legal arrangements

Subject to our different constitutional circumstances, and understanding that a one-size-fits all approach may not be the most effective, the G8 endorses the following core principles that are fundamental to the transparency of ownership and control of companies and legal arrangements. These core principles, consistent with the FATF standards, are essential to ensure the integrity of beneficial ownership and basic company information, the timely access to such information by law enforcement for investigative purposes, as well as, where appropriate, the legitimate commercial interests of the private sector.

The G8 also commits to publish national Action Plans based on these principles that set out the concrete action each of us will take to counter money laundering and tax evasion. To ensure G8 members are held to account for their commitments, 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.

1. 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.

2. Beneficial ownership information on companies should be accessible onshore to law enforcement, tax administrations and other relevant authorities including, as appropriate, financial intelligence units. This could be achieved through central registries of company beneficial ownership and basic information at national or state level. Countries should consider measures to facilitate access to company beneficial ownership information by financial institutions and other regulated businesses. Some basic company information should be publicly accessible.

[…]

5. The misuse of financial instruments and of certain shareholding structures which may obstruct transparency, such as bearer shares and nominee shareholders and directors, should be prevented.

[…]

7. Effective, proportionate and dissuasive sanctions should be available for companies, financial institutions and other regulated businesses that do not comply with their respective obligations, including those regarding customer due diligence. These sanctions should be robustly enforced.

8. National authorities should cooperate effectively domestically and across borders to combat the abuse of companies and legal arrangements for illicit activity. Countries should ensure that their relevant authorities can rapidly, constructively, and effectively provide basic company and beneficial ownership information upon request from foreign counterparts.

B. UK Action Plan to prevent the misuse of companies and legal arrangements

The UK is committed to fully implementing the revised Financial Action Task Force standards in order to improve the transparency of the ownership and control of companies and legal arrangements. This is a matter of good corporate governance as well as a means to tackle a wide range of illicit activity. The UK is committed to taking the following actions to do this.

[…]

2. Ensure the Companies Act 2006 and UK Money Laundering Regulations oblige companies to know who owns and controls them, by requiring that companies obtain and hold adequate, accurate and current information on their beneficial ownership.

3. Amend the Companies Act 2006 to require that this information is accurate and readily available to the authorities through a central registry of information on companies' beneficial ownership, maintained by Companies House. Consult on whether information in the registry should be publicly accessible.

[…]

7. Review of corporate transparency, including bearer shares and nominee directors, by the Department for Business, Innovation and Skills. This will start with the publication of a pre-consultation paper before September 2013.

8. Support the Overseas Territories and Crown Dependencies to publish Action Plans setting out the concrete steps, where needed, to fully implement the Financial Action Task Force Standards.

9. Improve international cooperation including the timely and effective exchange of basic and beneficial ownership information.

10. Implementation of the measures will be through, and at the same time as, transposition of the 4th EU Money Laundering Directive and UK Money Laundering Regulations, changes to the Companies Act 2006, as well as through other relevant bilateral and multilateral agreements[96].

234. In providing their Opinion on this Impact Assessment, the RPC noted that it should demonstrate further that the measure meets the G8 principles and G8 Action Plan in a way that minimises unnecessary costs to business.

235. As set out above, the UK has committed to require companies to obtain and hold information on their beneficial ownership, and to make this information publicly accessible through a central registry maintained by Companies House. Our policy provides for this, requiring companies to maintain a register of their beneficial owners and provide this information to Companies House. We have sought to do this in a manner consistent with other company law requirements to maintain registers and file information at Companies House. It is intended that this will facilitate familiarisation by companies and avoid costs that would be incurred by requiring information to be filed separately or differently (compared to other information). We therefore anticipate that the adoption of a broadly

[96] On the basis that company law is devolved in Northern Ireland, we will work together with the Northern Ireland Executive to take this forward.

consistent model across company filing requirements will deliver better outcomes in terms of burdens on business.

236. In addition, the underpinning aim of the policy is to prevent the misuse of companies, as indicated by the title of the G8 Principles and UK Action Plan. To meet that objective fully it has been important to ensure that we do not, in looking to minimise costs to business, inadvertently create loopholes which would allow misuse to continue. Such an outcome would clearly have a detrimental impact in terms of the realisation of benefits.

237. Therefore in developing the policy we have sought to strike an appropriate balance between proportionality and efficacy. We gave particular consideration, for example, to the scope of the requirements and the manner in which beneficial ownership information is obtained and updated. We are confident that the final policy position will deliver an outcome that is proportionate and effective – thereby meeting, but not exceeding, our G8 commitments.

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 given the substantial coverage of companies this did not identify any particular issues with this policy change.

242. 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

243. 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.

244. 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.

245. This policy will apply to UK incorporated companies and 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[97] 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.

246. It has been widely identified that 'shell' companies are often the vehicle of choice for money-laundering and other crimes[98]. 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"*[99]. By this very definition, we believe that the majority of shell companies would be classified as small or 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 US 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."*

247. 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.

248. 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.

249. We have undertaken analysis of the costs for small companies using the data obtained in the IFF Research company survey, weighted by the same methodology as for the overall figures. These estimates only use the 'best' estimate for the preferred option and for each cost estimate we have truncated the distribution at the same point as for the estimates for all companies. The methodology is described in full in **Annex A**.

250. 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.

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97 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.

98 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

99 *ibid*

Costs*	Small company mean	Large company mean
Transition costs per company	£92	£3,060
Ongoing costs per company	£22	£312

Table 5: Average costs for small companies

251. Small firms, despite their predominance in the population at 98%, account for only 64% of the one-off costs and 80% of the ongoing costs.

252. Nevertheless, from the outset we have considered measures to minimise burdens to small and micro businesses, including allowing 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.

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

Factor	Consideration
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	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 <u>all</u> 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	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 in part 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	We do not believe that the costs of complying with this policy change per company will warrant direct financial aid.
Opt-in and	We have considered and discounted non-regulatory approaches in our IA, given the

voluntary solutions	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	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. 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.

Wider environmental and social impacts

Factor	Consideration
Environmental impacts	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	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	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.
Health and well-being	This policy should prevent or deter crime which will have a positive impact on individuals' well-being. We will seek 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 an exemptions framework for individuals that might otherwise be at serious 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

254. 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).

255. 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 [...]*".

256. Implementation of a publicly accessible central registry of company beneficial ownership information 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
- we intend that there will be a framework of exemptions from public disclosure for individuals at risk.

257. 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 G7 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.

<u>Justice System</u>

258. Following standard IA methodology this IA assumes 100% compliance with the policy. A Justice Impact Assessment Test has also been completed and is awaiting final clearance from the Ministry of Justice[100].

259. We intend to 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.

260. 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.

<u>Devolved Administrations</u>

261. We do not anticipate any difference in impact on UK companies as a result of their registered office location. The requirements will apply in the same manner to all companies. Similarly, the requirements will apply in the same manner to all beneficial owners, irrespective of their country of residence.

K. Summary and preferred option with description of implementation plan

Summary

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

[100] As at 19 June 2014.

Cost / Benefit	Option 1 (Central Registry)	Option 2 (Non-regulatory option)	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 which are estimated at **£523m** pa (not including the transfer costs related to the impacts on the victims of crime)); and (2) increased transparency which could potentially have an impact on economic growth.	Few 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 deterrent benefits if criminals opt not to use UK companies, and increased awareness/ vigilance from the publication of information on the misuse of companies might have some impact on crime. There might be some increase in transactions from the greater transparency. These impacts are, however, 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.
Costs			
	Costs to Government are estimated to be **£70-109k** for the IT development of the registry and communication and **£220k** pa on-going for the maintenance. Cost to businesses are estimated to be **£417.4m** set up cost (familiarisation, identification, collection, collation and storage of data) and **£77.7m** 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 **£0.96m**.	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.

Table 6: Summary of options

Implementation plan

263. This reform necessitates primary and secondary legislation. Provision in primary legislation is contained within the Small Business, Employment and Enterprise Bill.

264. Once the policy has completed its Parliamentary passage, we would seek to implement the following high level implementation plan. This will be further refined as transitional and other arrangements are further developed.

- **Month 0**: Parliamentary passage of primary and secondary legislation.
- **Following Parliamentary passage**: Royal Assent, commencement of primary and secondary legislation.
- **On or before legislation coming into force**: Guidance developed and communicated to UK companies and their advisors.
- **On legislation coming into force or specified period thereafter**: 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 3 years**: Review of legislation (this will take the form of a formal review within three years of legislation implementing new 'check and confirm' arrangements coming into force).

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

Annex A – Methodology: The IFF Transparency and Trust Survey

A. Background

1. For the purposes of this final IA, we built on the existing evidence base with the following:

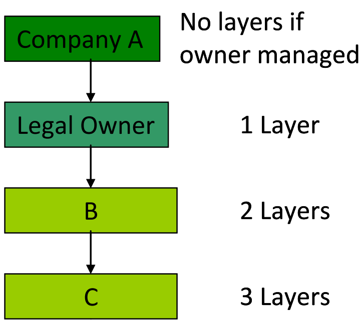
   - an extension to our original company survey, consisting of largely qualitative questions;
   - a series of focus groups consisting of businesses and trade associations; and
   - further discussions with law enforcement and tax authorities.

   The company survey was used to inform the way we treated the data collected in the original survey, whilst the focus groups were used largely to validate the estimates we produced in the consultation IA. Further discussion with law enforcers provided us with additional data on the scale of the problem and potential benefits as a result of enhanced transparency.

2. For the original company survey, which was first used to inform the consultation IAs, IFF Research conducted a representative 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 the proposed reforms on all UK companies. Respondents were asked questions to explore the likely cost impact of establishing a central registry of company beneficial ownership information, transparency around opaque arrangements involving company directors, the prohibition of corporate directors and the disqualification of certain directors.

Sampling

3. To identify the population of interest, we conducted a sample from the FAME[101] database, which is based on Companies House data. Companies were split into a 3x2 grid of quota cells based on corporate structure:
   - simple with 0-1 layers in the ownership chain;
   - reasonably complex with 2-3 layers of ownership (UK-owned, no trusts in the ownership chain); and
   - complex with over 4 layers and/or foreign ownership



   As well as company size:
   - micro and small (fulfilling 2 of 3 from the following criteria: (i) Turnover < £6.5m; (ii) Balance sheet < £3.26m; (iii) Employees < 50); and
   - medium and large (fulfilling 2 of 3 from the following criteria: (i) Turnover > £6.5m; (ii) Balance sheet > £3.26m; (iii) Employees > 50).

4. This sampling framework enabled our analysis to identify rigorously how costs would vary by company size and complexity. Ultimately, this shaped the proposed policy so as to minimise the burden on UK companies, whilst maximising the resulting crime reduction and economic growth enhancement.

Data Output

5. 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)[102]. The wages used were:

101 FAME database. 2013. Bureau Van Dijk Electronic Publishing.
102 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.

	ASHE wage data	Micro and small companies	Medium and large companies
Senior Management	Chief executives & senior officials	£48.20	£57.18
Middle Management	Corporate managers and directors (excluding chief execs & senior officials)	£18.33	£23.89
Administrative Staff	Administrative & secretarial occupations	£10.78	£11.59

Table 1: Wage rates used in the company survey

6. The estimated mean was weighted according to the original FAME sample below, such that more weight was given to cells with a greater number of companies. More specifically, 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. As a result, the overall mean is largely driven by the estimates from 'small, simple' companies.

Weighting grid	Simple	Reasonably complex	Complex	Total
Small / Micro	93.5%	2.9%	1.9%	98.3%
Medium / Large	0.92%	0.28%	0.55%	1.74%
			TOTAL	**3,187,112**

Table 2: Fame data split by company size and complexity

B. Issues with the original survey

7. In-depth analysis of the survey methodology and responses highlighted several issues. When the survey questionnaire was designed (August 2013), policy was in the early stages of development and was subject to consultation. In fact, IFF Research explained to BIS that some respondents struggled to answer the questions and some had varying interpretations of the questions.

8. We identified a number of striking distributions across all 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. For instance, the question relating to familiarisation costs for the creation of a register of beneficial ownership information, yielded the following distribution of responses:

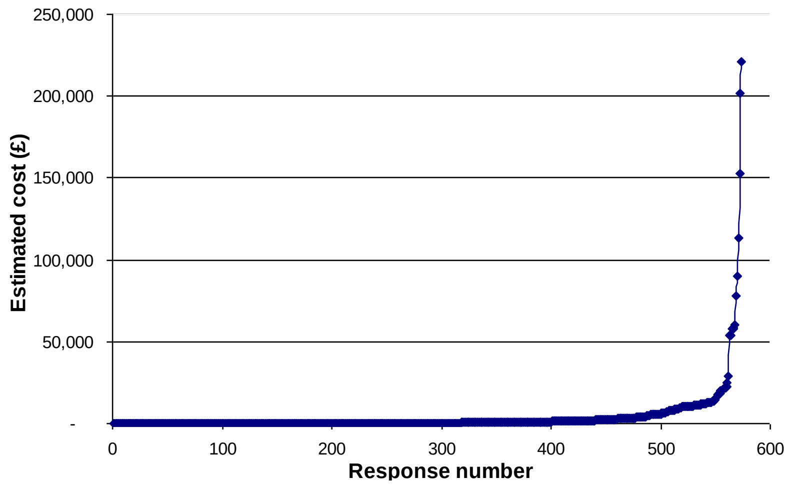


Figure 1 (above): Distribution of responses on familiarisation costs related to beneficial ownership.

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

Table 3: 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 analysis of these respondents showed no relationship between cost[103] and size (based on turnover, employees and assets) and complexity (based on the number of layers of share ownership).

C. The updated evidence base for the final Impact Assessment

10. IFF Research conducted a follow-up survey with 43 of the 574 respondents to interrogate their original answers and to identify whether their answers would change in the light of new policy detail. Although the follow-up survey used a relatively small sample, IFF Research was able to conduct in depth interviews with the respondents from the original survey.

11. We specifically targeted interviews at the respondents who gave either zero, low (under £5) or high (top 10%) quantitative estimates in the original survey. In total, we received 31 responses to the beneficial ownership questions and 12 responses to the corporate directors questions. Across all the questions we aimed for roughly a 50:50 split between ‘high’ and ‘low’ respondents.

12. Ultimately, the research findings guided us in developing the methodology for this final IA and determined the way in which we treated both the *low* and *high* respondents.

13. For the reasons set out below, the new survey indicated the original survey questions lacked the specificity required to elicit fully informed answers consistently. **We believe these issues have had an effect on the robustness of the responses and therefore on their overall suitability for <u>unqualified</u> use in our analysis of the costs**. The issues we identified with the survey are detailed below for both the beneficial ownership policy and the corporate directors policy. We faced the same issues in the survey with both policies so it is worthwhile discussing them jointly.

<u>Reasons companies gave high wage cost estimates</u>

- Misinterpretation of the questions (e.g. provision of annual cost estimates rather than for a single procedure. This gave estimates which were many times larger than they should have been).
- Companies provided initial upper estimates, which they expected to fall over time.
- Double counting (e.g. companies including compliance costs in their familiarisation cost estimate as well as reporting it separately).
- Reporting the total number of hours for all staff rather than a break down by staff level. This raised cost estimates substantially if the staff hours were recorded as senior staff time with their considerably higher wage relative to admin staff time for instance.

14. In addition to the four types of mistakes we commonly encountered from respondents in the original survey, respondents often revised down their original estimates when they were given new policy information:

- 54% (of the 24 companies which were asked how their estimates would change) revised down their estimates on beneficial ownership from an originally ‘high’ estimate.

103 Although there was a slight tendency for those giving high responses to be ‘large’ – around 60% were.

- 29% (of the 17 companies which were asked how their estimates would change) revised down their estimates on corporate directors, whilst 65% stood by their original ‘high’ estimate.

15. This finding reinforces our use of the four types of mistakes to inform our treatment of the data to remove a number of the extreme values. If all companies had revised down their estimates, we might have considered removing more of the outliers but we have adopted a more moderate approach here.

16. We by no means considered all the ‘high’ responses received in the first company survey invalid. However, in the light of the above we targeted the removal of high estimates primarily from ‘small simple’ companies, as described below - table 6 shows the highest estimates we used were still in most cases several thousand pounds for ‘large complex’ companies. Although the second company survey did not entirely determine how we treated the data, it did indicate to us that some proportion of cost estimates was implausible.

<u>Quotes from ‘high cost’ respondents:</u>

- In terms of familiarisation with the beneficial ownership proposals, once companies were given new policy detail they revised down their estimates considerably. One respondent, who previously estimated it would take one senior manager five hours and £10,000 in additional (legal) costs said:
- *“That would obviously take less if it could all be done by this* [13 pages of guidance for familiarisation] *and less digging had to be done and to make the explanation up front. Should reduce it by at least 25% if I have to give a number.”*
[micro/small, simple structure]

- Similarly, a representative from a small complex company revised compliance cost estimates down substantially after new policy information made the respondent realise compliance would be less onerous than originally expected:
- *“Those times and costs would go down considerably. Down by 90% because all the work’s done for you. They’re just saying “we’re here, hi!””*
[micro/small, complex structure]

<u>Reasons companies gave low wage cost estimates</u>

- Companies misunderstood and thought the reforms were not relevant to their company (particularly for beneficial ownership) so incorrectly assumed they would not undergo any cost for familiarisation or compliance.
- Difficulty in answering the hypothetical questions (e.g. most companies answering the corporate directors questions did not have a corporate director, so chose to give low responses.)

17. In the light of new policy information, 79% (of the 19 companies which were asked how their estimates would change) did not revise their estimates on beneficial ownership, whilst the remaining 21% revised up their original ‘low’ estimate.

Quotes from 'low cost' respondents:

- In the case of companies familiarising themselves with the beneficial ownership proposals, a typical response from a respondent who already knew their company's beneficial owner and understood the associated principles was:
- *"We have 2 shareholders with 50% share each, they're both directors of the company, they both live together and one of them is me. So we are both well aware of the changes and we don't really need to do much else."*
  [micro/small, reasonably complex structure]

Another comment related to a small simple company responding to a request was:

- *"We're only a small private owned company with a couple of shareholders so beneficial ownership is not really much of an issue. It would be one person (i.e. me) writing a letter I suppose, or responding to an email - no systems or infrastructures envisaged."*
  [micro/small, simple structure]

Business Focus Groups

18. Alongside the follow-up company survey we also held a number of focus groups with around 30 companies and six business representative organisations (listed in **Annex B**), which together represent at least 240,000 companies and many hundreds of thousand employees. These groups were orientated around validating or disproving the estimates we provided in the consultation IAs.

19. In the case of the beneficial ownership, of the six distinct types of cost, five of them were largely validated by the groups. Collation, processing and storage costs were only partially validated because some companies thought if paper records were required costs could be higher. Although the attendees found it difficult to place an accurate figure on how much it would cost them to follow a certain procedure, in general they thought our estimates seemed to be reasonable for small simple companies (around 94% of the population) but costs could be considerably higher for larger and more complex companies. Given that the figure was already weighted by the size and complexity of the company (as detailed below), we considered it to be consistent with the types of comments the groups made.

D. Methodology for the Final Impact Assessment

20. Despite its flaws, the original representative survey provides the most comprehensive dataset available, and we believe there is value in processing it to produce realistic and duly qualified cost estimates. The results from the original company survey, particularly at the upper end of the distribution, were surprising. Firstly, they didn't fully accord with the discussions we had with stakeholders and secondly it was not clear why the estimates were so high.

21. For the consultation IAs we also adopted a truncated mean approach (i.e. using only feasible values in the mean calculation) to adjust for extreme values. The RPC commented that some further analysis around how the estimates differ, if the data were processed differently, would be informative so we have refined our approach.

22. For this final IA, we were able to gather more evidence from an additional survey and business focus groups to build on the evidence we already had. Indeed, the analysis and evidence gathering for this IA have been in development since July 2013 and we have pursued every relevant evidence source fully. The new evidence enabled us to truncate the data on the basis of this new information. For instance, the second company survey suggested that the extreme 'high' cost estimates commonly suffered from double counting and misinterpretation. Put simply, these extreme estimates were found to be unfeasibly high and not appropriate to include in the dataset. This validated our approach of processing the data to arrive at realistic estimates.

23. Therefore, we have truncated the mean (i.e. used only feasible values in the mean) to adjust for extreme values. Truncation is a statistical technique which is commonly applied to survey data. On this occasion, we utilised a more robust technique to identify where to truncate and we truncated a lower proportion of the data than in the consultation IA.

Treatment of High Wage Cost Estimates

24. It is necessary to exclude implausible or unverifiable estimates at the high end of the distribution. Similarly to the consultation IAs we used a truncated mean for each survey question relating to costs. However, on the basis of the new evidence we gathered for this IA, we have revised our truncation method as follows:

    i) we trimmed the weighted values (rather than the unweighted values, as per the consultation IA) to target more effectively the implausibly high estimates, which were biasing our estimate of the mean upwards. This also enabled us to trim a lower share of the data relative to our previous approach in the consultation IA; and
    ii) we used a robust statistical technique (based on analysing the coefficient of variation[104]) to identify the specific point at which to truncate the mean.

25. To explain (i) further, as detailed above, each observation in the sample was weighted according to how commonly its company type (based on the 3 x 2 grid in table 2) was seen in the population. As a result, an estimate given by a small simple company was given a much greater weight than one given by a large complex company. Once these weighted values are totalled and divided by the number of observations, this ultimately produces a mean that is representative of the whole population.

26. By trimming weighted values, we are able to remove most efficiently the observations which are distorting the mean upwards. For instance, if a small simple company were to offer a cost estimate of £1,000, because that type of company is given a large weighting, this single response would drag up the mean substantially. On the basis of our second company survey, the relatively high responses were called into question for the reasons detailed above. It would therefore be sensible to remove the responses, which were incorrectly raising the mean beyond a feasible value. Moreover, adopting this approach helps to minimise the number of observations that are removed from the dataset.

27. With regard to (ii), for each quantitative question we plotted the coefficient of variation for each potential trim, as shown below for the cost of removing and replacing a corporate director. Adopting this approach rather than simply eyeballing the distributions to identify where to trim, gives us a robust objective rule which is founded upon minimising the sampling error. Trimming on a purely statistical basis, we should trim up to the lowest coefficient of variation (i.e. the global minimum). However, the estimated means produced on this basis produced results which were inconsistent with the costs we would expect based on our latest focus groups and company survey.

28. For this reason, we have adopted a second trimming approach, which trims after the next substantive fall in the coefficient of variation (i.e. the next lowest local minimum). This allows us to arrive at an estimate, which is more consistent with the figures which were validated by industry in our focus groups and company surveys. In the chart below, the vertical red line on the left is the suggested trim based on the first method (1%) and the vertical red line on the right is the suggested trim based on the second method (8%).

[104] The coefficient of variation is a measure of sampling error, which takes account of the size of the estimate, giving a relative measure of precision. It is calculated as the standard error divided by the mean. Lower figures imply a more precise estimate of the mean. Standard errors have been calculated taking proper account of the fact that we are using a weighted and truncated mean, such that the highest observations still contribute to the standard error.

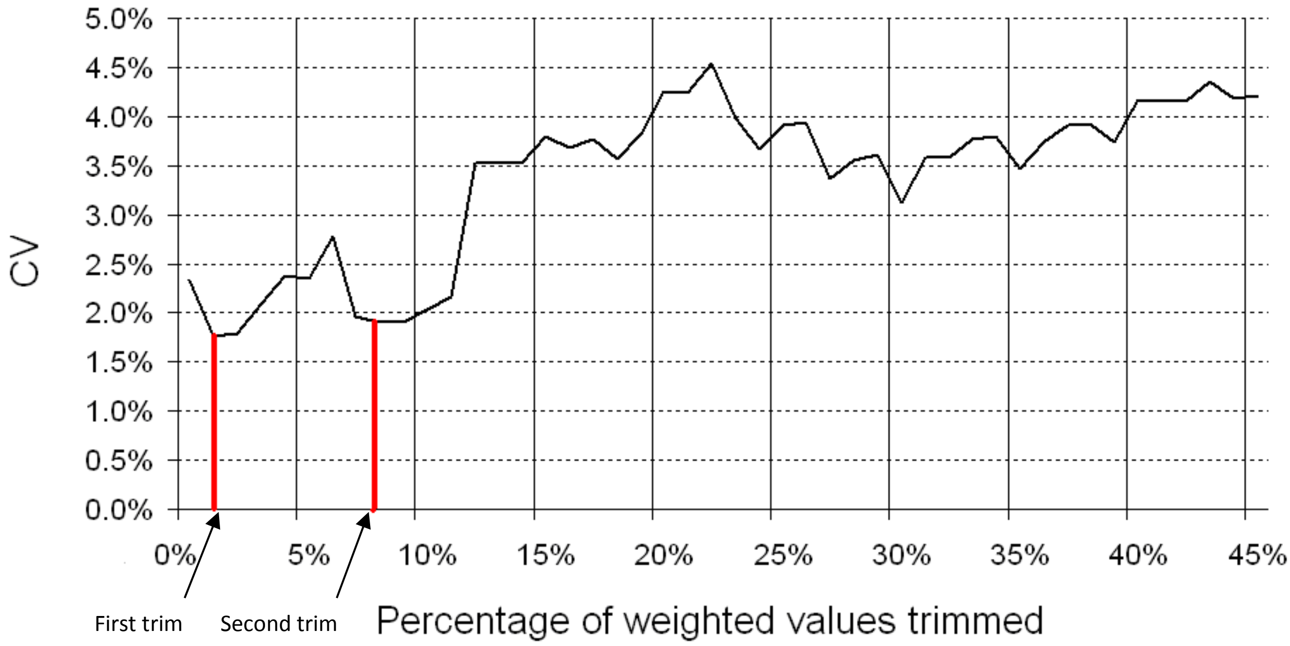


Figure 2: Coefficient of variation chart for the cost of removing and replacing a corporate director

29. To provide some sensitivity analysis around these estimated means, we used the following estimates:
    - **Low**: Mean from the second trimming approach (local minimum)
    - **High**: Midpoint between the two trimming approaches
    - **Best**: Mean from: (Percentage of remaining data after second trim x Second trimming approach mean) + (Percentage of data trimmed under second approach x Mean from first trimming approach)

    For instance, the best estimate in the case of removing and replacing a corporate director was calculated as follows: (93% x £58) + (7% x £191) = £67. This essentially assumes that for 93% of companies, £58 would be a reasonable estimate whilst £191 would be appropriate for the remaining 7%. The low estimate would be £58 (i.e. the second trim) and the high estimate would be £125, calculated as a mid-point between the first and second trims.

30. To explain our thinking further, based on the results of the second company survey and the focus groups, we felt we had to trim the data to arrive at reasonable cost estimates. Of the two trimming approaches we used, the estimates derived from the first trim were not reasonable based on the wider evidence we gathered. For this reason we applied the above sensitivity analysis, which uses both trims, to arrive at a range of estimates that fitted closely with the discussions we had with business.

31. The table below displays where the coefficient of variation led us to trim under the two chosen methods. We also provide the cost estimates for these two methods in addition to the low, best and high wage cost estimates, used in the calculations for this impact assessment. These estimates are in line with the BIS evaluation of the Companies Act 2006[105] in which 33% of the companies surveyed spent under 10 hours in total complying with the whole Companies Act over the course of three years (at the very most around £480 in wage costs).

	First trimming approach		Second trimming approach		Wage cost estimates		
Cost	Trim	Cost	Trim	Cost	Low	Best	High
Familiarisation with the beneficial ownership reforms	6%	£111	13%	£48	£48	£56	£80

105 http://www.bis.gov.uk/assets/biscore/business-law/docs/e/10-1360-evaluation-companies-act-2006-volume-1.pdf

Identifying and collecting information about the beneficial owner	1%	£45	8%	£5	£5	£9	£25
Responding to a request about your beneficial ownership	4%	£35	13%	£7	£7	£11	£21
Collation, process and storage of beneficial owners' data	1%	£53	9%	£9	£9	£13	£31
Updating beneficial ownership information annually	4%	£42	14%	£9	£9	£14	£26
Providing beneficial ownership information to a central registry annually	3%	£40	14%	£9	£9	£13	£24

Table 4: Wage cost estimates and trimming positions

32. However, as noted above, we trimmed on the basis of weighted cost estimates. Since around 94% of companies were 'small, simple', any estimate from a company of this type would be weighted relatively heavily. As a result, if a 'small, simple' company gave a relatively high cost estimate, combined with their large weighting, their estimate would be more likely to appear at the top of the distribution. It would therefore make it more likely to be trimmed from the dataset as an extreme value.

33. Our a priori knowledge of the likely costs as well as our evidence base (second company survey, business focus groups and consultation) suggested that, particularly for 'small, simple' companies, costs should be relatively low compared with larger more complex companies. This was largely because compliance would be far more straightforward. For this reason, it was deemed plausible that any 'small, simple' estimates at the upper end of the distribution were less reliable and hence correctly caught by the trimming methodology. By contrast, where possible, we avoided removing estimates from larger, more complex companies because compliance could be considerably more time consuming.

34. The table below compares the maximum cost estimates provided by 'small, simple' and 'large, complex' companies, when the data are untrimmed and at the first and second trimming points[106]. To explain further, iteratively trimming one percent of the data at a time will gradually remove the highest weighted values. As more data points are removed this reduces the threshold level for the maximum estimate, which feeds into the mean. However, the impact will differ by company type because generally the companies with the largest weighting (i.e. 'small, simple') will have their highest cost estimates trimmed first.

35. It is clear to see that at the second trim, the maximum allowed estimate for 'small simple' is substantially reduced. For instance for beneficial ownership familiarisation, the maximum untrimmed estimate for a 'small simple' company was £48,200 but after trimming, the maximum allowed estimate was £59. The maximum estimate for a 'large complex' company falls substantially but remains almost 100 times as large as the 'small simple' estimate. More specifically, it falls from £88,244 to £5,718.

36. This demonstrates that under our trimming method, we are primarily targeting the removal of the 'high' estimates from 'small simple' companies. However, we are not removing proportionately as many of the estimates from 'large complex' companies, for which costs might be substantially higher. This is in line with the evidence we gathered from the business focus groups and the follow-up company survey.

Cost	**Untrimmed**		**First Trim**		**Second Trim**	
	Max recorded estimate		**Max allowed estimate**		**Max allowed estimate**	
	'Small	***'Large***	***'Small***	***'Large***	***'Small***	***'Large***

[106] We provide only the data for the second trim for illustrative purposes because this shows the largest change from the untrimmed data.

	'simple'	complex'	simple'	complex'	simple'	complex'
Familiarisation with the proposed beneficial ownership reforms	£48,200	£88,244	£236	£13,447	£59	£5,718
Identifying and collecting information about the beneficial owner	£1,475	£6,407	£386	£6,407	£22	£2,287
Responding to a request about your beneficial ownership	£5,398	£4,864	£96	£4,864	£12	£1,372
Collation, process and storage of beneficial owners' data	£8,819	£34,678	£3,889	£34,678	£138	£18,230
Updating beneficial ownership information annually	£2,699	£4,735	£96	£4,735	£14	£1,372
Providing beneficial ownership information to a central registry annually	£12,050	£5,248	£96	£5,248	£12	£1,946

Table 5: Maximum allowed estimates under trimming method

37. To demonstrate the impact of trimming on the means for different company type, for illustrative purposes, table 6 provides the means for 'small simple' and 'large complex' companies. Naturally, by trimming, the means for both company types fall. However, the mean for 'small simple' companies falls substantially more than for 'large complex' companies. For instance, the mean familiarisation costs related to beneficial ownership fall from £1,098 to £46 for 'small simple' companies. By contrast, for 'large complex' companies, the mean falls from £1,858 to £946. This demonstrates the types of mean we arrive at under the trimming approach compared to the means we would arrive at without trimming.

Cost	**Untrimmed**		**First Trim**		**Second Trim**	
	Mean		**Mean**		**Mean**	
	'Small simple'	***'Large complex'***	***'Small simple'***	***'Large complex'***	***'Small simple'***	***'Large complex'***
Familiarisation with the proposed beneficial ownership reforms	£1,098	£1,858	£133	£1,102	£46	£946
Identifying and collecting information about the beneficial owner	£70	£296	£41	£296	£5	£228
Responding to a request about your beneficial ownership	£181	£204	£39	£204	£7	£156
Collation, process and storage of beneficial owners' data	£88	£350	£55	£350	£11	£230
Updating beneficial ownership information annually	£144	£205	£45	£205	£10	£171
Providing beneficial ownership information to a central registry annually	£214	£205	£43	£205	£10	£172

Table 6: Estimated means under second trimming method and untrimmed

Treatment of Zero Wage Cost Estimates

38. It is also necessary to consider how to treat zero values. A large number of survey respondents answered that there would be zero costs arising, for example, from the proposed policy changes, as detailed in section C. 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. For this reason, we re-coded these observations such that they were set to the minimum recorded positive estimate. For instance, if the minimum cost estimate any company in the sample gave was £5, all zero responses would be re-coded to £5. This is a reasonable approach, which reflects the assumption that all companies would have to undergo some cost. It also minimises the bias to the dataset, which we would otherwise have been introduced by re-coding the values to a higher value which is not supported by any evidence. This will raise the estimate mean cost relative to simply including zero cost values in the calculation of the mean.

39. The main benefit of not removing the zero values from the sample as we did in the consultation IA is that we are not losing such a substantial number of observations. Since we need to trim at the top end of the distribution, also removing the zero responses from the bottom end would dramatically reduce the sample size. The table below shows that there was considerable variation in the number of zero responses for each question but on average some 30% of observations were zero.

	Number of zero observations	**Zero observations as % of all observations**
Cost of company familiarisation with the beneficial ownership reforms	67	12%
Cost of identifying and collecting information about the beneficial owner	387	67%
Cost of responding to a request about your beneficial ownership	185	32%
Cost of collation, process and storage of beneficial owners' data	162	28%
Cost of updating beneficial ownership information annually	119	21%
Cost of providing beneficial ownership information to a central register annually	76	13%

Table 7: Zeros observations in the sample

Treatment of Additional Cost Estimates

40. 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 Research 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.

41. In the follow up study, IFF Research further interrogated the additional costs. Companies generally considered these costs to arise from legal and accountancy advice for the beneficial ownership questions. In the light of new evidence, the majority of companies stood by their original estimate but similarly to the wage cost estimates, a number of companies gave comments that cast some doubt over the validity of the highest estimates. The main issues we noticed were:

- some companies commented that their additional cost estimates were very much a 'worst case scenario';
- some companies mentioned that they might not in fact incur additional costs; and
- a few companies noted that on reflection they may have included some staff time in their additional cost estimates – meaning there was some double counting.

42. For instance, one 'high cost' additional cost response, came from a company which previously estimated additional costs of £5,000. In the second survey they revised their answer, no longer feeling that it would cost their company anywhere near this, and would be more likely to cost them around £100. This was because, on further discussion, they felt that they would not need to incur legal fees for this particular task.

"I think the most likely outcome is that the cost will be negligible by which I mean less than £100 and it would be an awful lot to take it £5,000 to be honest on the basis that there's no cost in terms of fees, so we're only talking about internal time."

[medium/large, simple structure]

43. On this basis, it seemed sensible to truncate the dataset using the same method that we applied to wage costs. The only difference in method for our treatment of additional costs was the inclusion of zero values. In this case, we consider it an entirely valid response for a company to state that it would not undergo optional additional costs because it could comply with the proposals using in-house resources.

44. The table below details where we chose to trim and the resulting estimated mean. These estimates are in line with the BIS evaluation of the Companies Act 2006[107] in which 64% of the companies surveyed spent under £500 in total on additional costs to comply with the whole Companies Act over the course of three years.

	First trimming approach		Second trimming approach		Additional cost estimates		
Cost	**Trim**	**Cost**	**Trim**	**Cost**	**Low**	**Best**	**High**
Company familiarisation with the proposed reforms	4%	£111	12%	£25	£25	£36	£68
Identifying and collecting information about the beneficial owner	1%	£65	6%	£15	£15	£18	£40
Responding to a request about your beneficial ownership	1%	£87	6%	£15	£15	£19	£51
Collation, process and storage of beneficial owners' data	1%	£37	4%	£11	£11	£12	£24
Updating beneficial ownership information annually	1%	£113	4%	£27	£27	£30	£70
Providing beneficial ownership information to a central registry annually	1%	£63	4%	£21	£21	£22	£42

Table 8: Additional cost estimates and trimming positions

107 http://www.bis.gov.uk/assets/biscore/business-law/docs/e/10-1360-evaluation-companies-act-2006-volume-1.pdf

Annex B – Focus Groups Attendance List

Companies in attendance	**Business representative organisations in attendance**
Abell Morliss International	ICSA - Compliance
Armess	BCC
Assoc of Company Registration Agents	ICAEW
Bank of America Merrill Lynch	Law Society
Broadhead Accountants	ICSA - Software International
Capita Asset Services	ICSA - Customer Services
Centrica PLC	*(We have separately discussed these policy proposals and analysis with a range of other business representative organisations including the CBI and IoD.* *In total, these business representative organisations represented at least 240,000 companies and the views of hundreds of thousands of employees.)*
Charles Russell LLP	
Chettleburgh’s Ltd	
Company Registrations Online	
Creditsafe	
Dun and Bradstreet and BIPA	
Entone Group	
Experian	
Jordans Trust Company Ltd	
LegalinX-7Side	
MSP Secretaries	
Naylor Wintersgill	
Penfold & Redstone Ltd	
PWC Tax	
RBJ Tax & Accountancy Services	
Slaughter and May	
Stanley Davis & Co.	
The London Law Agency Ltd	
Thomson Reuters	
Thrings Solicitors	
Ward Williams	
Wilder & Coe Ltd	

Annex C: Sensitivity Analysis

The assessment of the base case presented above relies upon a number of assumptions. The key ones of these are:

1. The number of firms affected
2. The treatment of only one-off additional costs being included in the costs. This includes the use or otherwise of Trust and Company Service Providers (TCSP) which help companies incorporate and may have an ongoing relationship with the company thereafter to undertake certain regulatory obligations (e.g. filing company returns). These include Company Registration Agents, some lawyers and some accountants.
3. The use of the IFF Research data exclusively in the costings but informed by alternative sources of data
4. The sharing of costs between the company and the beneficial owners
5. Number of changes in a year
6. The number of beneficial owners
7. Other assumptions

The statistical treatment of the data to arrive at high, best and low estimates of the costs is set out in **Annex A** and will not be repeated here.

1. Number of firms

Clearly if we were to reduce the number of firms covered there would be a significant change to the EANCB as it is a key number which is used throughout the calculations – halving the number of firms (keeping the proportion of large/small and ownership complexities the same) would halve the costs and negatively affect the benefits.

The number of firms affected is taken from the FAME database. This uses Companies House and other organisations' data. It is judged to be the best available data for this purpose as it breaks down companies by size and complexity of ownership and fully accords with Companies House official filings numbers. Also the policy has explicitly set out the need to close loopholes, and it does this by minimising the number of exemptions to where there is ownership information already in the public domain.

2a. Additional costs

The base case includes only the one-off additional costs that companies might incur (i.e. purchasing of external accountancy or legal advice). This is because the second survey indicated that there were very significant differences in interpretation of these questions across respondents in the first survey and significant uncertainty about what was meant. Some companies indicated that their estimates were a worst case, others that they would actually not incur any costs and still others noted that there was some double counting between wage costs and additional costs. Furthermore our view was that the policy design – of the reporting being added to the 'check and confirm' process and the simple updating of existing records and guidance being provided – would mean that ongoing additional advice would not usually be required. There is also the consideration that, if it were required, the need could rapidly decay and thus the annual costs would decrease over the appraisal period.

However, if the ongoing additional costs (of £30pa for updating the companies own records and £22pa for sending the information to Companies House annually) are also included in the cost calculation, (ie an extra (£30pa * 0.8 + £22pa) * 3.185m) the EANCB rises to £211.4m. However for the reasons noted in the main body of the text we do not think that this is likely to reflect the true position, especially over time.

If the additional costs were excluded entirely the EANCB would fall to £82.4m (i.e. £73.4 one off cost plus £24.4pa) * 3.185m). However again we do not think that this would reflect the true costs as we expect that, given the possible novelty of the concept of beneficial ownership for some companies and the new legal requirement coupled with the link to Companies House, the use of accountants and lawyers as a source of advice is entirely plausible.

2b. Use of TCSPs

Companies House data indicate that 73% of new companies use TCSPs to help them incorporate[108]. Furthermore, research commissioned by Companies House estimates that 41% of companies use accountants or agents to file their Annual Return.

Assuming that TCSPs would undertake the familiarisation on behalf of the company with which they have an ongoing relationship (ie 41% of companies) the one-off costs could fall to £344.4m from the base case of £417.4m (ie the familiarisation costs would be only £55.9*59%* 3.185m[109]): giving an EANCB of £90.9m (compared to £97.5m on the base case).

If we assume that 41% of companies will use TCSPs to send in their additional beneficial ownership information alongside the ‘check and confirm’ process (see 2 above), and 59% of companies send in their own returns, the calculation for reporting to Companies House becomes (£22 * 0.41) + (£13.4 * 0.59) * 3.185m, rather than (£13.4 * 3.185m). The EANCB then rises to £106.5m.

3. Data sources

The base case uses IFF Research data from the initial representative company survey, adjusted statistically and broadly validated by the focus groups and follow-up survey. We considered that this was the best available information.

However, if we take the Global Witness report[110], the costs are considerably lower than our base case at £24m one-off costs and £2.3m ongoing costs – this gives an EANCB of £3.9m. As noted above however this research is not based on direct engagement with companies but solely on expert opinion to set the assumptions. It does not cover all the likely costs (e.g. familiarisation and identification).

The PWC estimate of the cost of filing of £12.39 per company is only marginally lower than the £13.40 per company used as the base case: in this case the EANCB falls to £95.0m.

4. Sharing of costs between the company and the beneficial owner

The base case has the costs of identifying the beneficial owner split 50:50 between the company and the beneficial owner. This is because both are obligated under this proposal and where the costs fall will depend on the nature of the shareholding/control (e.g. where an individual has a direct interest in more than 25% of the company’s shares or voting rights, the company will be required to identify that individual. In other cases, the beneficial owner will more likely need to self-disclose their interest). As we do not know how many beneficial owners there are we have not been able to quantify the costs to the individual.

If we assume all the costs were to fall on the company, the EANCB rises to £101.3m. If the percentage borne by the company falls to 25% of the costs the EANCB falls to £95.6m. The small size of the changes in the EANCB from these costs is due to them being only 5% of the total one-off costs.

5. In-year changes to information

In the base case, we assume that the in-year changes to information will occur on average 0.8 times a year, based on the number of times a person moves residence, the number of time non-traded shares are bought and sold and an estimate of the number of beneficial owners per company providing information (using legal shareholders as a proxy for beneficial owners).

[108] Companies House, February 2014

[109] i.e. it is assumed that the TCSPs are already included in the 59% who familiarise themselves. They themselves might incur a higher familiarisation cost if more of their staff need to know about the requirements than that assumed by the survey respondents. However we have no further data on this.

[110] John Howell & Co Ltd for Global Witness (2013): *Costs and Beneficial Ownership Declarations*

We have not been able to gather further information to validate these estimates or to provide better estimates. However, for illustrative purposes, if the number of changes falls (driven by 25% fewer changes in circumstances or 500,000 fewer beneficial owners) to 0.6 times per year the EANCB changes to £90.7m. If the number of changes increases (driven by 25% more changes in circumstances or 500,000 more beneficial owners) to one change per year the EANCB changes to £104.2m.

The EANCB is broadly resilient to changes in these assumptions about in-year changes, however there is a lack of evidence around the number of beneficial owners providing additional information, and clearly the greater the number of beneficial owners the higher the EANCB.

6. Beneficial owners

Linked to section 5 above, we have no robust evidence as to the number of beneficial owners likely to incur a cost, nor what that cost might be. Thus we have provided no estimate of the costs of these proposals to individuals in the base case. The main body of the text sets out why this is the case. It also sets out the actions we would expect a beneficial owner to undertake. Whilst communication with the company is likely to be low cost (e.g. via email), familiarisation and understanding the requirements are likely to be higher. For illustrative purposes alone, the table below takes the £55.9 one-off company familiarisation costs and applies it to a range of beneficial owner numbers: it also gives an annual average discounted cost (starting in 2015).

Number of beneficial owners incurring one-off costs for familiarisation/ understanding	One-off cost at £55.9 per beneficial owner	Annual average discounted cost
500,000	£27,950,000	£2,609,162
1,000,000	£55,900,000	£5,218,325
2,000,000	£111,800,000	£10,436,650
3,000,000	£167,700,000	£15,654,974
4,000,000	£223,600,000	£20,873,299
5,000,000	£279,500,000	£26,091,624
6,000,000	£335,400,000	£31,309,949
7,000,000	£391,300,000	£36,528,274

The assumption of two beneficial owners per company used to calculate the base case company cost for updating its own records would imply individual one-off average discounted costs of around £33m per year.

7. Other assumptions

Other aspects of the cost calculation are:

- In-year changes to beneficial ownership information will be provided by the beneficial owner themselves (except where the company should be expected to know of the change – e.g. significant share transactions) so for companies updating information will be mainly an administrative task which can be incorporated into their existing processes. In these circumstances we might therefore expect the ongoing costs of updating information to be lower than in the base case.
- The company will need to inform the beneficial owner that their information will appear on the register. However this can be done as part of the initial identification process and, for some companies, the person asking the question will themselves be the beneficial owner. In some cases a further email/letter will need to be sent from the company to the beneficial owner, however we do not know how many this will be, nor the cost.
- Those companies that are exempt will need to tell Companies House that they are exempt. However, we expect this to be part of their ongoing communications with the organisation (e.g. part of the 'check and confirm' process) rather than a stand-alone action.

- For some companies they will only need to gather information from their parent companies rather than request information from their entire ownership chain. This will decrease the costs estimated in the base case for these companies.
- In the base case we assumed that the cost to parents of responding to requests for information from their subsidiaries would in effect be equivalent to the cost of replying just once (i.e. 130,000 actions). Where a parent incurs the cost of responding to every subsidiary (i.e. 335,500), the cost of this element of the proposal rises from £3.9m to £10.1m: the best estimate EANCB then becomes £98m.
- Following standard methodology this IA assumes 100% compliance. We have no evidence to indicate the potential level of non-compliance, however where non-compliance occurs clearly the benefits would be lower, as would the costs. However, as noted in the main body of the IA we anticipate 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. Where the matter is referred we would anticipate costs to the court service and potentially also the prison service.

Conclusion

Overall, the assumptions used to construct the base case using the revised IFF Research results, broadly validated by the follow-up survey and focus groups, are robust against changes in assumptions where we have other data to use. The exception to this is around the inclusion of all of the ongoing costs for external accountancy/legal advice. This more than doubles the EANCB. In the base case we have included the estimates of the costs which we think are most valid (i.e. the one-off costs), given the uncertainty around these numbers in the survey. There is also a lack of evidence around the number of beneficial owners which makes any calculation of the costs to individuals unreliable.

Annex D: Additional information

1. This Annex provides additional information on the problem under consideration; the policy variables discounted as part of our development of the preferred option; further detail on potential benefits to law enforcement and tax authorities; and a more detailed explanation of the theoretical and empirical framework linking trust, transparency and growth.

(i) The problem under consideration: case studies from law enforcement and tax authorities

2. UK law enforcement and tax authorities have provided a number of examples which give an indication of the scope and scale of the misuse of companies:

    - Companies are used in **Missing Trader Intra Community (MTIC) VAT fraud**[111]. HMRC's 2011/12 estimate of the MTIC element of the VAT tax gap is between £0.5bn and £1bn. They note that MTIC fraud reduces the amount of money available to fund essential public services and has a negative impact on the economic health of genuine businesses through unfair competition. MTIC fraud may be run by Organised Criminal Groups, many of whom have links to other serious crime such as murder or extortion.
    - Further criminality may be involved through **money laundering of the proceeds of the fraud**. As an example, HMRC has one case in which a PAYE assessment of around £800k and a MTIC assessment of £3m is in place. They note that the legal owners of companies involved in such frauds (i.e. the persons named on the company's register of members) are rarely the real beneficial owners.
    - The City of London Police has indicated that much of the corporate crime they investigate – such as **boiler room fraud and scams**[112] – involve UK companies. The Financial Services Authority (now Financial Conduct Authority (FCA)) note that victims lose an average of £20k to these scams, with as much as £200m being lost in the UK each year. They note that the biggest individual loss recorded by the police is £6m[113].
    - 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[114].
    - 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[115].

(ii) Description of options considered: discounted policy variables from our preferred option

(1) The definition of beneficial ownership

3. Some respondents to the BIS discussion paper recommended decreasing the 25% threshold to 10%, or removing it entirely. We have opted 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

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[111] MTIC VAT fraud is an organised criminal attack on the EU VAT system in which fraudulent traders acquire goods VAT free from EU Member States; charge VAT on their onward sale and go "missing" to avoid paying the VAT charged to the relevant tax authorities.

[112] Boiler room frauds involve the cold-calling of investors offering them worthless, overpriced or even non-existent shares, promising high returns. See the Financial Conduct Authority website, March 2013: http://www.fsa.gov.uk/consumerinformation/scamsandswindles/investment_scams/boiler_room

[113] See Financial Conduct Authority website, March 2013: http://www.fsa.gov.uk/consumerinformation/scamsandswindles/investment_scams/boiler_room

[114] July 2013: http://www.northyorkshire.police.uk/11613

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

have any real control 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

4. Some respondents to the discussion paper recommended placing all UK companies in scope, with no exemptions, on the basis that information disclosed to the market under the FCA Disclosure and Transparency Rules does not necessarily equate to beneficial ownership information. There might be a particular concern around companies listed on non-regulated markets, as they are not subject to the additional regulatory requirements that accompany listing on a regulated market.

5. However, we want to avoid duplicative requirements and minimise additional regulatory burdens and costs. As public, trading companies these companies are subject to generally higher levels of regulation and public scrutiny and we therefore judge that the risk of illicit activity is lower. Furthermore, 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; contributing to a higher overall policy cost.

6. Some respondents recommended placing all UK formed corporate and legal entities in scope. Whilst this might have the potential to enhance the overall benefits derived from the policy, these entities do not have any existing relationship with Companies House, and in many cases (e.g. credit unions, charities and building societies) are regulated by another Government agency. We do not therefore consider that these entities should come within the scope of this policy, but note that proposed EU measures on beneficial ownership could require them to take similar action to that proposed in this IA.

7. On balance 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.

8. A few respondents to the discussion paper 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[116]. Furthermore, it has been widely identified that 'shell' companies are often the vehicle of choice for money-laundering and other crimes[117], which this policy has as a stated objective to reduce. A 2012 study defines a shell company as: "*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*[118]". By this very definition, we believe that the majority of shell companies would be classified as small and micro businesses.

9. Compared to public listed companies, private companies, including small and micro private companies, are also subject to fewer regulatory disclosure requirements. 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 therefore consider it imperative that small and micro companies are in scope.

[116] 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

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

[118] *ibid*

(3) How beneficial ownership information is obtained

10. Some respondents suggested that additional or alternate disclosure obligations should be placed on the legal owners of the company. In some cases this might have increased the efficacy of the policy (for example, where the company or an enforcement agency could identify the legal owner even if not the unknown beneficial owner). However, it also had a clear potential to increase cost and complexity in terms of (duplicative) disclosures being made by multiple parties. Where a company seeks information from the legal owner about a beneficial owner, the legal owner will be statutorily bound to reply. On that basis, we do not think that the potential benefit of such an approach would outweigh the costs and do not intend to pursue this approach.

(4) Providing and updating information in the central registry

11. The *Transparency and Trust* discussion paper sought views on replicating the information and disclosure regime which currently applies in respect of company legal owners (i.e. shareholders). 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 then be required to provide the names and details of the interests in the company to the central registry on an annual basis, address would also be given on incorporation. This model was supported by many respondents in the business community.

12. However, other respondents were in favour of requiring more information to be collected, as outlined above. This view was shared by law enforcement agencies. Whilst the cost of collating and storing this additional information may lead to higher overall costs (both for the company and Companies House), it is considered that these will be outweighed by the potential increased benefits. This is because collating more information will reduce the occurrence of 'false positives' (i.e. where two individuals appear to be the same because, for example, they have the same name) and therefore enhance the investigative ability of enforcement agencies. The wider community may derive similar benefit from more accurately being able to identify who really owns or controls the company in question through using the public register alone. Overseas agencies may need to make fewer information requests to UK enforcement agencies because they can obtain information by searching the public record. This would also have a cost and time saving for UK authorities.

13. Some respondents to the discussion paper argued that information held by Companies House should be updated within a few days or weeks of a change occurring. However, on balance we do not think that the increased cost of this would outweigh any potential additional benefit. This is because there will always be the option of inspecting the register held by the company itself (which will be up to date) and because we intend to require companies to show **all** changes that have occurred in-year on the register held by Companies House. This means that the scope for companies and individuals to change beneficial ownership information just before or after a return is made, to conceal that individual's interest in the company, is removed. Furthermore, 'real-time' updates might still have needed 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.

(iii) Monetised and non-monetised costs and benefits of each option (including administrative burden): additional information on the potential benefits to law enforcement and tax authorities

14. 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."

15. 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."*

16. The Met noted that the role of the regulated entities (e.g. banks, accountants and insurance companies) in undertaking their due diligence under the AML laws to identify beneficial owners, whilst helpful, might not always provide up to date information.

17. For example, in 2011 the Financial Services Authority (now Financial Conduct Authority) published a report[119] 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."*

18. 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.

19. HMRC has indicated that having a central source of information has the potential to help them identify individuals who have been involved in previous suspect companies and design a managed intervention programme around them to allow more focus on the highest risk – allowing them to get ahead of the risk curve rather than trying to recover losses after the event. They have also noted that identifying company beneficial ownership would allow early identification of sectors they are trying to break into with the development of appropriate risk based responses. Finally, it would facilitate the identification and distraint of assets; the identification and management of connections and associations; the identification of Phoenix traders who pose a risk to the revenue which can be mitigated by imposing securities; and the identification of disqualified directors who are acting as beneficial owners.

20. The problem of opaque corporate ownership structures is not limited to UK companies; 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. For example, HMRC has indicated that if overseas jurisdictions were to implement a central registry of company beneficial ownership information, they could potentially identify tax evasion committed by UK citizens, thereby increasing the total tax take of the UK. Although HMRC cannot quantify this amount, they anticipate it to be significant. This highlights the potential cross-jurisdictional benefits to be derived from this policy. Nevertheless, given the intangible and indirect nature of this benefit, we have not included this in our assessment.

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[119] FSA (2011): *Banks' management of high money-laundering risk situations*

21. The OECD reported[120] 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."*

22. 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 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."*

23. 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 […][121]."*

24. 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."*

(iv) Benefits: the theoretical and empirical framework linking trust, transparency and growth

25. 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[122]. 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)[123] 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[124] were five times higher for the least trusted supplier.

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[120] OECD (2001): *Behind the Corporate Veil: Using Corporate entities for Illicit Purposes*

[121] 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, 2012

[122] 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.

[123] 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

124 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.

26. There is also a known link between overall economic growth and trust[125], with the literature commonly identifying a significant positive relationship between the two. This emerges because trust motivates investment, innovation and more broadly entrepreneurship[126]. 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)[127] 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)[128] 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.

27. 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)[129] 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)[130], 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.

28. Analysis of US States by Dincer and Uslaner (2010)[131] 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).

29. 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)[132] 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.

30. 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.

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125 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.
126 However, the literature must carefully control for reverse causality, i.e. how far high growth countries are generally more trusting.
127 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
128 Zak, P.J. and Knack, S. (2001): *Trust and growth*, Economic Journal, 111, 295–321.
129 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
130 Horváth, R. (2013): D*oes trust promote growth?*, Journal of Comparative Economics, Elsevier, vol. 41(3), pages 777-788
131 Dincer and Uslaner (2010): *Trust and Growth* Public Choice (2010) 142: 59–67
132 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

31. Two notable exceptions are Bjørnskov (2012)[133] and Botazzi et al (2010)[134], 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)[135], 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.

32. Indeed, during discussions with business at a series of focus groups, they largely validated this view: *"If a company knew who was behind the company they were making a deal with, it could save them from making bad decisions".*

33. Moreover, one business commented that *Transparency and Trust* might encourage Foreign Direct Investment, if the package makes it easier for overseas companies to see with whom they are dealing.

34. 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)[136] 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.

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133 Bjørnskov (2012): *How Does Social Trust Affect Economic Growth?* Southern Economic Journal, Working Paper 06-2
134 Botazzi, L., Da Rin, M. and Hellman, T. (2010*): The importance of trust for investment* NBER Working Papers 16923
135 Guiso, L., Sapienza, P. and Zingales, L. (2008): *Trusting the Stock Market*. The Journal of Finance, Vol 63, Issue 6, pp2557-2600
136 Whiteley, P. (2000): *Economic Growth and Social Capital*, Political Studies 48, 443-466

Title: Transparency and Trust - Prohibiting Bearer Shares in UK Companies **IA No:** BIS BE024 **Lead department or agency:** Department for Business, Innovation and Skills (BIS) **Other departments or agencies:** Companies House, HMT, HMRC, MoJ	**Impact Assessment (IA)** **Date:** Published 25 June 2014 **Stage:** Final Stage **Source of intervention:** International **Type of measure:** **Primary legislation** **Contact for enquiries:** Email:TransparencyandTrust@bis.gsi.gov.uk Tel: 0207 215 1848

Summary: Intervention and Options

RPC Opinion: GREEN

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**
-£1.26m	-£1.22m	£0.12m	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 can erode trust and damage 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. 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 intends to enhance transparency, in conjunction with the wider *Transparency and Trust* measures, of who really owns and controls UK companies so as to prevent the potential for their misuse. It will also ensure the UK fully meets international Global Forum on Tax Transparency standards and Financial Action Task Force (FATF) recommendations on bearer shares activity. 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)

0) Firstly we consider the 'do nothing' option and conclude that it would not meet the policy objectives.
1) The first substantive option is to abolish bearer shares (the recommended option).
2) The second substantive option is a mandatory custodian arrangement.

We recommend Option 1 because: a) it has greater benefits (unquantified) around stimulating economic activity; and b) the Net Present Value is much more favourable in comparison with Option 2 (-£1.26m compared with -£9.01m). This is primarily because it does not require the large ongoing costs associated with a custodian arrangement.

Option 2 does however have 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).

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: Jenny Willott Date: 22 June 2014

Summary: Analysis & Evidence — Policy Option 3- Preferred

Description: Abolition of bearer shares

FULL ECONOMIC ASSESSMENT

Price Base	PV Base	Time Period	Net Benefit (Present Value (PV)) (£m)		
Year 2013	Year 2013	Years 10	Low: -	High: -	Best Estimate: -1.26

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	-		-	-
High	-		-	-
Best Estimate	1.2		0	1.3

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

In terms of transition, there are costs to both bearer shareholders (£87,000) and bearer share issuing companies (£23,000) of becoming familiar with the policy change. There are also costs to bearer shareholders in identifying themselves to the company and converting the shares (£41,000). There are legal costs to bearer share issuing companies from converting the shares into registered shares or cash (£840,000). There are communication (time and administration) costs associated with the legal requirement to contact bearer shareholders (£175,000). Lastly, there is a cost to government of implementing and publicising the changes (£41,000). There are yearly costs arising from abolition of £6000 due to the reduction in the ease of transferability for bearer shareholders.

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

There are non-monetised costs associated with potentially higher financing costs to companies who currently issue bearer shares and will 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 take prescribed steps to communicate with their bearer shareholders.

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 of the policy change cannot be monetised, in part because of the way in which law enforcement agencies record data. See below for description on non-monetised benefits.

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

There are non-monetised benefits to bearer share issuing companies, individuals and to 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.

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 (applied here where relevant). 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 and assumptions, on the basis of a follow-up company survey.

BUSINESS ASSESSMENT (Option 3)

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 4

Description: Custodian arrangements for bearer shares

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: -9.01**

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	-		-	-
High	-		-	-
Best Estimate	1,2		0.9	9.0

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

In terms of transition, there are costs to both bearer shareholders (£87,000) and bearer share issuing companies and banks (£32,000) of becoming familiar with the policy change. There is also a cost to government of publicising the changes (£2,000). There are ongoing costs of £6,000 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 £900,000 per year.

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

There are non-monetised costs associated with potentially higher financing costs to companies who currently issue bearer shares and will no longer able to sell equity at a relative discount to those purchasers who value the anonymity and transferability associated with these securities.

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 of the policy change cannot be monetised, in part because of the way in which law enforcement agencies record data. 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.

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 (applied here where relevant). 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 and assumptions, on the basis of a follow-up company survey.

BUSINESS ASSESSMENT (Option 4)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs: **0.9**	Benefits: **0**	Net: -0.9	No	NA

Transparency and Trust – Prohibiting bearer shares in UK companies

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 which erodes trust and damages the business environment. Both crime and a lack of trust can impede economic growth.
- There is a dual rationale for government intervention to address the problems of corporate opacity. Where a lack of transparency around corporate structures 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, through bearer shares. 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 of the *Transparency and Trust* package are to reduce crime and improve the business environment so as to facilitate economic growth.
- More specifically, the objective of this policy is to ensure the UK fully meets the international Global Forum on Tax Transparency standards and the Financial Action Task Force recommendations on bearer shares activity.
- The options considered to achieve this objective include :
    - **Option 0**: 'do nothing.' This does not achieve the stated policy objectives.
    - **Option 1 (recommended)**:
        - 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**:
        - 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**: Delivers 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 (£87,000) and bearer share issuers (£23,000) to becoming familiar with the policy change. There are also costs to bearer shareholders in identifying themselves to the company and converting the shares (£41,000). There are legal costs to bearer share issuing companies to convert the shares into registered shares or cash (£840,000). There are communication (time and administration) costs associated with the legal requirement to contact bearer shareholders (£176,000). Lastly, there is a cost to government of implementing and publicising the changes (£41,000). There are yearly ongoing costs of £6,000 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 being 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 taking voluntary steps to communicate with their bearer shareholders.

- **Option 2 :** Delivers non-monetised benefits to government, individuals and business of a reduction in illicit activities and an increase in economic activity. There are transition costs to both bearer shareholders (£87,000) and bearer share issuers and banks (£32,000) to becoming familiar with the policy change. Lastly, there is a cost to government of publicising the changes (£2,000). There are ongoing costs of £6,000 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 £900,000 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.
- The costs and benefits described in this Impact Assessment (IA) are based on the most robust and up to date analysis available.

Implementation

- Primary legislation is being taken forward to implement this policy (although some small changes might need to be taken forward through secondary legislation).

A Background

A lack of corporate transparency

1. This IA (IA) considers the costs and benefits of action to address the use of bearer shares, in line with the UK's G8 commitments made in June 2013[1]. Other IAs in this package cover other proposed actions to improve the transparency of ownership and control of UK companies; taken together, the package of measures should meet the G8 objectives to tackle the misuse of companies.

2. 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 corporate or 'front' directors. The G8 described these problems thus:

3. *"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 […][2]."*

4. The G8 endorsed eight core Action Plan Principles, consistent with FATF standards, which are fundamental to the transparency of ownership and control of companies and legal arrangements[3]. Principle five states that *"the misuse of financial instruments and of certain shareholding structures which may obstruct transparency, such as bearer shares […], should be prevented."* Based upon the principles 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, the UK Action Plan included the commitment to consider the need to tackle the misuse of bearer shares[4].

5. 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*."

6. 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. The mechanisms in place in the UK to ensure the availability of ownership and identity information for bearer shareholders have been found to be insufficient. To achieve full compliance with the Global Forum's standards and to protect our international reputation and standing we must therefore *"[…] either take necessary measures to ensure that robust mechanisms are in place to identify the owners of bearer shares or eliminate such shares."*

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1 UK action plan to prevent misuse of companies and legal arrangements (June 2013): https://www.gov.uk/government/publications/uk-action-plan-to-prevent-misuse-of-companies-and-legal-arrangements

2 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.

3 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/207532/G8-Action-Plan-principles-to-prevent-the-misuse-of-companies-and-legal-arrangements.pdf.

4 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/207520/UK-Action-Plan.pdf.

7. 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.*[5]*"* In April 2014, the government published its response to views received on the discussion paper, confirming the intention to abolish bearer shares.

8. 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'). This has the legal effect that the shares belong to whoever holds the physical share warrant and 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 comparative advantage to registered shares - physical transference of the share warrant was significantly faster. Modern usage of electronic share registration for ordinary shares has however considerably reduced this advantage. A fundamental feature of bearer shares is that they are associated with holding a piece of paper - they cannot be held electronically.

9. 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 issue of new bearer shares, and to abolish existing bearer shares, to prevent the potential for misuse.

10. 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 transparency – reducing the potential for illicit activity

11. Estimates vary as to how much criminal money is generated and laundered within and through the UK. A 2012 EU-sponsored study estimated that about €25bn a year is laundered from UK crime[6]. The Home Office judges that in 2010/11, UK organised crime generated about £13 billion, of which they judge about £10.5bn is laundered. This figure excludes 85% of fraud and other non-organised crime[7]. Furthermore, the social and economic costs of organised crime in the UK are estimated to be £24bn[8], of which £8.9bn are associated with fraud.

12. Internationally, the European Commission's 2013 Impact Assessment of 'Anti-Money Laundering and Terrorist Financing'[9] points to United Nations[10] estimates of global criminal proceeds

5 BIS, July 2013: https://www.gov.uk/government/consultations/company-ownership-transparency-and-trust-discussion-paper.
6 Project 'ECOLEF', the Economic and Legal Effectiveness of Anti-Money Laundering and Combating Terrorist Financing Policy (November 2012)
7 Home Office (2013) *Understanding organised crime: estimating the scale and the social and economic costs*
8 Home Office (October 2013) *Serious and Organised Crime Strategy*. This estimate does not include money laundering.
9 European Commission (2013) *Impact Assessment : proposal on the prevention of the use of the financial system for the purpose of money laundering, Including terrorist financing* (for revision of the third money laundering directive)
10 UNODC (October 2011) *Estimating illicit financial flows resulting from drug trafficking and other transnational organized crimes: Research report*.

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[11].

13. 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[12] 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[13].

14. Moreover, as the Government's Serious Organised Crime Strategy[14] 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.

15. 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)[15] has observed that "almost every economic crime involves the misuse of corporate vehicles [ie companies]." A World Bank review[16] reported that 150 of the 213 grand corruption cases investigated involved the use of at least one corporate vehicle to hide beneficial ownership and the true source of funds; the World Bank has confirmed that 26 of these cases involved UK corporate vehicles. In these 150 cases, the total proceeds of corruption were approximately $56.4bn. Meanwhile, the World Economic Forum (WEF)[17] 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.

16. 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 G7[18], 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.

17. UK law enforcement and tax authorities have in addition provided case studies which give an indication of the scope and scale of the misuse of companies. 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. The Serious Fraud Office (SFO) and Metropolitan Police Service (the 'Met') have highlighted a number of cases in which UK and/or overseas-incorporated companies are used to channel illicit funds through the UK; hold UK assets

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11 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.

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

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

14 Home Office (2013) *Serious Organised Crime Strategy* (the £24bn cost excludes money laundering)

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

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

17 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."*)

18 Prior to 2014, the G8, including Russia.

such as property; or perpetuate fraud involving UK citizens. Amounts up to £50m can be involved in such crimes. Recovering the proceeds can be incredibly difficult - if not impossible - not least because of the multi-jurisdictional nature of the various companies involved in the ownership chains.

18. Companies are used in Missing Trader Intra Community (MTIC) VAT fraud[19] - HMRC's 2011/12 estimate of the MTIC element of the VAT tax gap is between £0.5 and £1 billion. MTIC fraud may be run by Organised Criminal Groups, many of whom have links to other serious crime, and further criminality may be involved through money laundering of the proceeds of the fraud. The City of London Police has indicated that much of the corporate crime they investigate – such as boiler room fraud and scams[20] – involve UK companies. The Financial Services Authority (now Financial Conduct Authority (FCA)) note that victims lose an average of £20,000 to these scams, with as much as £200m being lost in the UK each year. The SFO and the 'Met' have highlighted a number of cases in which UK and/or overseas-incorporated companies are used to channel illicit funds through the UK and hold UK assets such as property; or perpetuate fraud involving UK citizens.

19. To take a single striking example, 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 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)[21].

20. These authorities have made a strong case for action to increase corporate transparency. The Serious Fraud Office (SFO), the National Crime Agency (NCA), the Crown Prosecution Service, the Attorney General's Office, HMRC, the City of London Police and the Metropolitan Police Service (the 'Met') have been engaged in the development of the Transparency and Trust package generally, and this IA 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[22].

<u>Corporate opacity and corporate governance</u>

21. *"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.

<u>Specific problems associated with bearer shares</u>

22. Currently in 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

19 MTIC VAT fraud is an organised criminal arttack on the EU VAT system in which fraudulent traders acquire goods VAT free from EU Member States; charge VAT on their onward sale and go "missing" to avoid paying the VAT charged to the relevant tax authorities.
20 Boiler room frauds involve the cold-calling of investors offering them worthless, overpriced or even non-existent shares, promising high returns. See the Financial Conduct Authority website, March 2013:
http://www.fsa.gov.uk/consumerinformation/scamsandswindles/investment_scams/boiler_room
21 http://www.northyorkshire.police.uk/11613
22 Including evidence provided by SOCA prior to the launch of the National Crime Agency in October 2013.

determining non-disclosure where the information is sought for improper purposes. This ensures transparency of legal ownership of UK companies.'

23. There are, however, ways in which legal owners of shares can conceal their identity entirely. 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 – a bearer share.

24. 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 comes forward themselves to claim a dividend[23]. 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[24].

Scale of the use of bearer shares

25. Analysis indicates that 1233 UK companies have issued bearer shares, of which around 787 are 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[25].

26. 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[26].

27. 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.

The scope for misuse

28. Bearer shares may be used to conceal ownership for lawful purposes:

- if a company was 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.

29. 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.

23 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.'
24 There are legislative means to identify the holders of bearer shares in UK companies, but these are not compliant with current international standards, are labour intensive and expensive. 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. The fact that these powers are not open to law enforcement agencies to use without disclosing confidential information is also a core weakness.
25 Companies House data, 2013.
26 Responses to BIS letter to bearer share issuing companies.

30. 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[27]. 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, even those with low levels of corporate transparency,[28] 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.

31. Without Government intervention, there is unlikely to be sufficient collective action by industry to address these issues; particularly given the potentially criminal nature of the activity we are aiming to address.

The need for change

32. 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 a key means of facilitating tax evasion and money laundering. The Global Forum specifically recommends to the UK that we : *"[…] should either take necessary measures to ensure that robust mechanisms are in place to identify the owners of bearer shares or eliminate such shares".* The UK achieved a rating of largely compliant in 2013 and bearer shares were one of three elements which we need to improve in order to achieve full compliance with the standards. The Global Forum will consider whether our process for abolishing bearer shares represents an appropriate mechanism for identifying the owners of bearer shares. If the UK is not assessed as effectively meeting these standards, it could have an adverse impact on our international reputation and standing. This may in turn have a detrimental effect on the UK's competitiveness.

33. Under the UK's G8 Presidency last year, 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.

34. 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 (or register of people with significant control). The continued existence of bearer shares would be conceptually and operationally inconsistent with that, and could offer a means of evading identification and sanction.

C. Rationale for intervention

35. 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

27 BIS (2013) *Transparency and Trust Discussion Paper.*
28 e.g. Panama and the Cayman Islands.

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

36. 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 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.

37. 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[29], 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, corporate directors and 'front' 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.

38. 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[30]. A Home Office rapid evidence review (February 2014) concluded that corporate entities can be used to enable or assist criminality, to launder money or to provide prestige or perceived legitimacy. UK enforcement agencies have provided examples of the types of activity that can be facilitated using opaque corporate structures. These include tax crimes such as MTIC fraud; hiding stolen assets and the proceeds of crime; fraud; and drug and people trafficking.

39. The anonymity afforded by the corporate structure facilitates crime, which can lead to costs to the economy and more widely to society. These costs include the social 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[31]. The aim of this policy to address the regulatory failure affecting the transparency of corporate ownership and control is to reduce the opportunity for financial criminal activity and thus reduce these costs to the UK.

40. 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

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[29] Brougham 2011 *Entrepreneur Wealth and the Value of Limited Liability*

30 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.

31 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.

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.

41. 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'.*

42. 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*[32]*."*

43. 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)[33] 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[34] do not directly identify the mechanism or prove causality, they highlight that reducing crime will support growth.

<u>II. Imperfect/asymmetric information affecting the operation of the business environment</u>

44. 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.

45. 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*[35]*."* 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.

46. 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.

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32 UNODC (October 2011) *Estimating illicit financial flows resulting from drug trafficking and other transnational organized crimes: Research report.*
33 Goulas and Zervoyianni (2013) '*Economic growth and crime: does uncertainty matter*' Applied Economics Letters, Vol 20, issue 5, pp420-427.
34 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.
35 Hannigan 2003 *Company Law*

47. 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.

48. Where bearer shares are in issue, 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.

49. 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)[36], greater shareholder unity enables shareholders to hold companies to account more effectively, which is thought to generate efficiency, corporate profit and therefore economic growth[37]. 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.

50. 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.

51. The **second** is in terms of those who engage with a company. They could want to know about the people with whom they are dealing.

52. 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 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.

53. 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, or receiving correctly, goods/services or inadvertently financing crime. This makes economic transactions/activities less attractive[38] 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)[39] find that companies which keep a greater proportion of their information private require a greater compensating return

[36] BIS (2012) '*The Kay Review Of UK Equity Markets And Long-Term Decision Making'*.

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

38 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.

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

for the lack of transparency, i.e. they face a higher cost of capital. This is a common finding in the economic literature[40].

54. Moreover, 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[41]. 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.

55. While 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[42] 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.

56. 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 rational and competitive.

57. Opacity could also drive adverse selection[43]. 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 business 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[44]. On this basis, a lack of transparency and trust can inhibit optimal economic activity.

58. 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[45].

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40 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.

41 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.

42 Gigerenzer, Gerd and Selten, Reinhard (2002). *Bounded Rationality*. Cambridge: MIT Press.

43 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.

44 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.

45 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.

59. Though 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)[46] 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.

60. 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 objective

61. 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 needs to meet these standards.

62. 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.

63. 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 the UK fully meets international Global Forum standards and FATF recommendations on bearer shares activity.

64. In meeting these objectives we will also consider how best we can:

- 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;
- minimise the potential for adversely affecting an individual's property rights; and
- ensure that sufficient transitional and communication methods arrangements are made.

E. Description of options considered

Option 0 – Do nothing / Status quo

65. 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.

46 Whiteley, P. (2000). "*Economic Growth and Social Capital*" Political Studies 48, 443-466.

66. 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 ways to achieve the required degree of protection without the additional risks of the transferability and complete lack of paper trail for law enforcement agencies that bearer shares afford.

    This is our least favoured option.

Option 1 - Abolition of bearer shares (preferred)

67. 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 to convert them to the registered shares specified in the share warrant.

68. 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.

69. 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.

70. We propose to adopt a similar model in the UK. This would mean prohibiting the issuance of new bearer shares from the date of commencement of the measures, and providing a set period of time in which existing bearer shares could be converted to the registered shares specified in the share warrant. The length of time allowed should be long enough to 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. In the Consultation Stage IA the RPC asked for more detail on this point, which we are now in the position to provide (see below).

71. Option 1 is our recommended option for the reasons set out in the next section on costs and benefits - relating to promoting economic growth and reducing crime.

Option 2 - Mandatory custodian arrangements

72. This option includes:

    - ensuring existing bearer shares are held by a bank under a custodian arrangement; and
    - potentially also prohibiting the issue of new bearer shares.

73. 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.

74. This practice could be modelled on American depository bank services using American Depository Receipts (ADRs). ADRs are issued by a US depository bank. The depository bank holds the underlying shares and in relation to the holders of the ADRs 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 would hold legal title to the shares.

75. 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).

Consideration of alternatives to regulation

76. We do not think that a non-regulatory approach would be effective in meeting our policy objectives to reduce crime and improve the business environment so as to facilitate economic growth.

77. 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. In addition, where companies did not comply with a voluntary approach, it would remain difficult for those engaging with a company to identify those with whom they are really engaging.

78. 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*[47] (for example, education and communications strategies to raise awareness of the impacts of serious and organised crime). 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. 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.

79. A non-regulatory approach would probably 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. Indeed 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.

80. 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. We might lose influence over other jurisdictions, meaning less change globally and UK citizens and enforcement agencies being impacted by crime conducted by overseas companies in the UK.

47 Home Office (October 2013) *Serious Organised Crime Strategy* https://www.gov.uk/government/publications/serious-organised-crime-strategy.

F. Monetised and non-monetised costs and benefits of each option

81. 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.

Option 1: Abolition of bearer shares (preferred)

Benefits

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

82. The proposed policy to reduce the use of bearer shares will help to prevent crime by enhancing corporate transparency and directly removing a mechanism commonly used to facilitate crime. Consultation with law enforcement agencies revealed strong support for action across the *Transparency and Trust* package including with respect to 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.

83. 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.' The NCA "support[ed] the proposals in the Transparency & 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 as likely to deliver benefits in terms of combating criminal activity.

84. However, 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.

85. On this basis, we have, as set out below, sought to partially monetise the benefits arising from reduced crime of reducing the use of opaque arrangements involving company directors.

Total economic cost of fraud

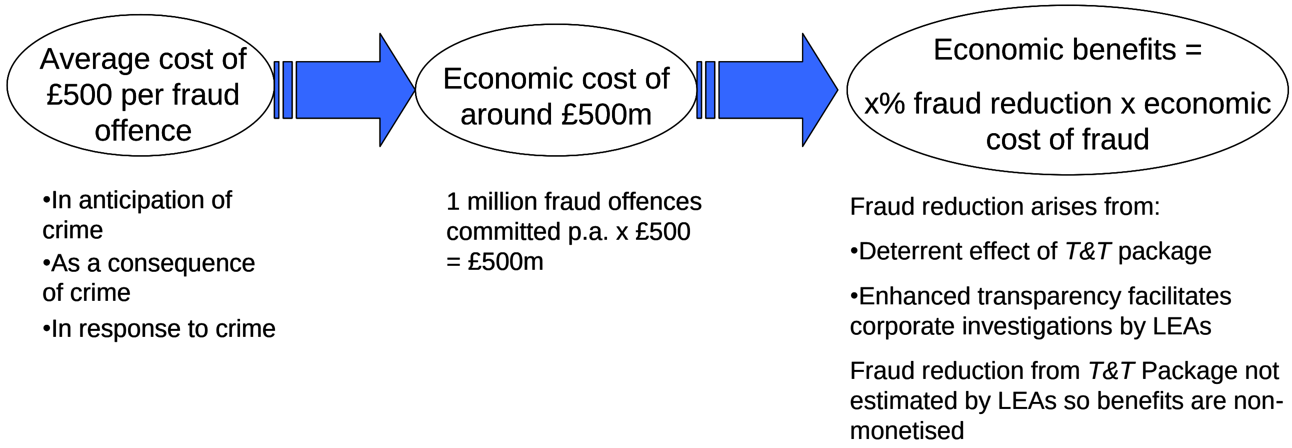

Figure 1: The logic chain behind the benefits of the Transparency and Trust package

86. 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[48]; insurance expenditure; lost output; and costs to the Criminal Justice System, including the police.

87. The economic cost of crime for a full range of offence categories has been estimated by Brand and Price (2000)[49]. 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.

88. The methodology places a value on the opportunity cost of resources used:

- in anticipation of crime (e.g. insurance[50] 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[51]).

89. 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.

90. We have uprated the average cost estimates for inflation to arrive at estimates in 2013 prices, according to standard HMT GDP deflators[52], 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

48 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.
49 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.
50 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
51 The estimated impact on the Criminal Justice System (CJS) is based on the Home Office 'flow and costs model'. The model estimates the long un 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.
52 https://www.gov.uk/government/publications/gdp-deflators-at-market-prices-and-money-gdp-march-2013

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	2013
		Cost (£m)	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

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

Table 1: The economic cost of fraud – a report from the Home Office and Serious Fraud Office (NERA, 2000)

91. 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.

92. 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.

93. To arrive at an estimate, we multiplied the average cost of fraud offences by ONS (2013)[53] crime figures. We estimate that there were 1 million fraud offences across the UK in 2012/1354. On the basis of 1 million fraud offences being committed in 2012/13 with an average cost of ≈£500[55] we

53 Office for National Statistics (2013) 'Crime in England and Wales, year ending June 2013 – Appendix tables'.
54 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).
55 To note unit costs are rounded for presentation in the text, with original figures used for calculation to give overall estimates.

estimate that the total economic cost is £523m, of which £496m falls on the public sector[56] and £27m falls on the private sector. This is calculated as follows:

≈£500 x £1m = £523m[57]
Average cost per offence x number of offences

The potential impact of this policy intervention

94. 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 or capability if companies are more transparent. This deterrent effect could in turn reduce costs for law enforcement agencies.

95. 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.

96. 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 from implementing the comprehensive package, is likely to be greater than the sum of its parts.

The scale of the economic benefits

97. 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:

Reduction in crime	Economic benefit
2% reduction in crime	£10.5m (2% of £523m)
5% reduction in crime	£26.1m (5% of £523m)
10% reduction in crime	£52.3m(10% of £523m)

Table 2: Reduction in crime including transfer payments (based on £500 cost of fraud)

98. 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 pa falls on the public sector and £270m pa 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.

56 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.
57 To note unit costs are rounded for presentation in the text, with original figures used for calculation to give overall estimates.

99. If the package resulted in a 2% reduction in crime, it would yield benefits of £28.5m. If the package resulted in a 5% reduction in crime, it would yield benefits of £71.4m. If the package resulted in a 10% reduction in crime, it would yield benefits of £142.7m

100. 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[58]. The Home Office analysis excludes money laundering, which as mentioned above has a significant global impact.

101. 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 Wellbeing programme led by ONS[59].

102. 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)[60] 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[61] does not directly identify the mechanism through which crime affects growth, it has repeatedly been highlighted that reducing crime will support growth.

B2. Improving the business environment: benefits to companies and individuals from corporate transparency supporting the business environment

103. 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.

104. 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.

105. 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.

58 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.

59 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.

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

61 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.

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[62]. Therefore increased corporate transparency can increase economic growth through the mechanism of increasing trust and reducing transaction costs.

106. 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

107. Companies House analysis indicates that 1233 UK companies have issued bearer shares, of which around 787 are trading, the remainder being dormant. This figure will exclude listed companies[63]. We assume for the purpose of this IA that active and dormant companies would incur the same level of cost[64].

C1. Cost to individuals/businesses who currently own bearer shares: anonymity and transferability costs

108. The anonymity afforded by bearer shares is likely to be perceived as an advantage for those who hold them. This could 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 a letter to all 1233 UK bearer share issuing companies. We had 468 respondents, 467 of which were 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 a 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.

109. However, there is a lack of evidence in the literature about the economic benefits from anonymity. Therefore it is not possible to fully quantify this cost.

110. 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.

111. 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.

62 The importance of trust in economic transactions is highlighted in Fukuyama, F. (1996) '*Trust the social virtues and the creation of property'*.
63 For companies whose shares are traded on a relevant market, and are subject to the Vote Holder and Issuer Notification Rules in Chapter 5 of the Disclosure and Transparency Rules (DTR5 companies) there is no requirement to provide shareholder information to Companies House.
64 Please note: costs have been rounded in this section to avoid spurious accuracy.

112. Ideally we would wish to estimate the following economic relationship: (Number of bearer shareholders) * (unit benefit per bearer shareholder from anonymity and transferability).

113. In order to generate an estimate, we have pursued the following approach.

114. 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[65]. 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.

115. 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.

116. 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 pro forma[66] 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[67] 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, though this is excluded from the analysis as it is a transfer.

117. 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[68]. 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 = £6,000.

118. Some former bearer shareholders would choose to convert to cash instead of the registered shares specified in the share warrant. 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.

C2. Cost to individuals/businesses who own bearer shares: familiarisation, administration and time costs

119. 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.

120. 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

65 Internal Companies House data.
66 http://www.sse.com/uploadedFiles/Controls/Lists/Investors/Shareholder_forms/StockTransferFormApril_2012.pdf.
67 ASHE date 2012.
68 PitchBook & Grant Thornton Private Equity Exits Report, 2012 Annual Edition.

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.

121. Ideally, we would want to understand the following economic relationships:

Familiarisation costs

122. (Number of bearer shareholders) * (unit familiarisation costs)

Administration and time costs

123. (Number of bearer shareholders) * unit time cost + unit monetary cost associated with exchanging bearer shares)

124. In order to generate an estimate, we have pursued the following approach.

125. 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.

126. 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. Firstly 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. Secondly, due to the 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. 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.

127. Therefore, in the absence of alternative information we used the cost of familiarisation with the reforms to use of corporate directors as part of the *Transparency and Trust* package as a proxy. The weighted mean costs per company are £29. If we apply this to the estimated 3000 bearer share owners then this gives us an estimated transition cost of £87,000 (3000 * £29).

128. 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.

129. Further steps the bearer shareholders need to take will include identifying themselves to the company. Though we do not intend to specify identification processes as part of the primary legislation, for completeness we consider a potential means of confirming identity - the standard Post Office procedure for verifying identity both in terms of the fee charged and the opportunity cost of the customer's time. The Post Office state a charge £7.50 for identity verification (2013 prices)[69]. They also provide an estimated duration of 20 minutes[70]. Assuming (in the absence of

69 http://www.postoffice.co.uk/document-certification-service.

other available information) a time cost of £19[71] 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).

130. 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 £41,000 (3000*£13.50). This assumes that it would not take additional time to, for example, locate the share certificate.

131. In their comments on the Consultation Stage IA the RPC asked to see more detail of measures used to deal with those shares which remain unconverted at the end of the conversion period and their impacts on business. There is a lack of available evidence on the proportion of shares that will remain unconverted at the end of the nine month surrender period, though we have very much designed the system to incentivise early surrender and minimise unconverted shares.

132. If we look to international examples, Belgium has recently implemented a transitional process for the conversion of existing bearer shares. However, no evidence on compliance is publically available from Belgium. Indeed, even if it were, Belgium provides a poor comparator given that bearer shares were in popular use across the country and the consequent long period for conversion required the introduction of additional measures in order to move towards Global Forum standards. Therefore, in accordance with Better Regulation guidance[72], in the absence of evidence to the contrary, we have assumed 100 per cent compliance. This implies that there will be no impact on business.

133. Taken together, we can estimate transition costs arising from familiarisation and administration for bearer shareholders to be £128,000 (£87,000+£41,000).

C3. Cost to companies who issue bearer shares: financing costs

134. 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.

135. 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.

136. (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 communication costs

137. Alongside those who hold bearer shares, there are also likely to be familiarisation, administration and communication costs to issuers of bearer shares.

138. Firstly, this will include the familiarisation costs associated with bearer share 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

70 BIS telephone interview with Post Office, 2013.
71 ASHE data, 2012.
72 Better Regulation Framework Guidance.

shares or sell the shares; this will lead to administration costs to issuing companies. Thirdly, there will be communications cost associated with notifying bearer shareholders of the change. In addition to any voluntary search action a company might undertake, they will be legally required to: a) place a notice in the Gazette; b) put a notice on their website throughout the nine months (if they have one); and c) communicate using their normal method i.e. as for dividends. The company must do a) and c) again at month 8 but only if the bearer shares haven't been surrendered before then.

139. Ideally we would wish to understand the following economic relationship:

140. (Number of bearer shareholders) * (unit familiarisation cost + unit administration costs + unit communication costs).

141. In order to generate an estimate, we have pursued the following approach.

142. 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.

143. 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 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. £29), which gives a total transitional familiarisation cost of £23,000 (779*£29).

144. There would also be administration costs to a bearer share issuing company, in terms of converting the shares from bearer shares to the registered shares specified in the share warrants. Market data from Companylawsolutions.co.uk.com[73] (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).

145. In terms of the communication costs, there are three components. The first component relates to placing a notice in the Gazette. Companies House charge a fixed fee of £57 for this.

146. There is also the opportunity cost of time associated with drafting the notice, making the change online and so on. Companies House internal modelling suggests that it would take approximately 20 minutes for a company to conduct this action[74]. We assume that the company director would deal with this issue. For these purposes, we assume that a company director earns the mid-point between the median wage (£13 per hour) and the median wage of a ‘Corporate Manager or Director’ (£24 per hour) including the standard non-wage uplift (17.8 per cent - to take into account non-wage employment costs. This gives a cost of £19 per hour. Given that it will take twenty minutes the cost per company will be £6 (19/3). We then need to multiply both the fixed fee

73 http://www.companylawsolutions.co.uk/prices.shtml
74 Companies House.

and the opportunity cost of time by the number of bearer share issuing companies (1233). This gives a cost of £78,000 (1233*(£57+£6)).

147. Companies will be required to provide this information twice if bearer shareholders have not converted within 8 months. Therefore, an upper bound estimate would be £155,000. The lower bound estimate is £78,000. In the absence of any further evidence about the proportion of bearer shareholders that will convert their shares during the first eight months of the nine month surrender period we take the midpoint of this range which equals £117,000.

148. The second component relates to updating the company's own website. The Companies Act IA[75] states that the cost of requiring a company updating a website to disclose preliminary annual results, full accounts and reports involves very little additional cost (i.e. is negligible) Given that we assume we have already considered the cost of drafting the text above and wish to avoid double counting then this implies a cost of zero.

149. The final cost component relates to communicating with the bearer shareholders using the usual channels. This involves contacting the issuer by post or email, as per their usual method of communicating with shareholders. An estimate of this cost can be found from the *Transparency and Trust* Survey where the cost of sending an update email or letter to Companies House about beneficial ownership information is estimated at £13. If we multiply this figure by the estimated number of bearer shareholders then this gives £39,000 (3000*£13). Companies will be required to provide this information twice if bearer shareholders have not converted by month 8. Therefore an upper bound estimate, which assumes that none of the bearer shareholders have converted in advance of the 8 month letter, would be £78,000 (£39,000*2). The £39,000 figure is a lower bound estimate, which assumes that all bearer shareholders have converted in advance of the 8 month letter. In the absence of any further evidence about the proportion of bearer shareholders that will convert their shares during the first eight months of the nine month surrender period we take the midpoint of this range which equals £59,000.

150. Therefore total quantified costs are equal to £175,000 (£117,000+59,000)[76].

151. Any wider search costs resulting from voluntary steps a company may choose to undertake to identify its bearer shareholders are not readily quantifiable. We did consider using information from the *Transparency and Trust* Survey as a proxy but there was not an appropriate analogy to draw upon.

152. Again, given the lack of evidence in this area, and in accordance with better regulation guidance, we assume 100 per cent compliance in terms of converting shares during the nine-month surrender period.

153. This gives a total cost of £1m (£23,000+£840,000+£141,000).

C5. Costs to government

154. There will be a cost involved in communicating the abolition of bearer shares to bearer share issuing companies. We intend to maintain communication with known bearer share issuing companies as part of 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[77].

75 BIS (2007) *Companies Act 2006: Regulatory Impact Assessment* http://www.bis.gov.uk/files/file29937.pdf
76 Figures do not add up exactly due to rounding.
77 Companies House invoice, 2013.

155. We envisage there could be two separate letters issued, perhaps one in month 1 and another in month 8. This gives a total cost of £1700 (£840*2). 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[78].

156. There would also be transitional development costs to Companies House of £39,000[79]. 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[80].

157. Companies House have noted that, based on the current level of information, they do not anticipate needing to charge higher fees to companies as a result of this proposal. Therefore these costs will not be passed on to business.

<u>Option 2: Mandatory custodian arrangements</u>

Benefits

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

158. A policy change through which owners of bearer shares must use a bank as a custodian of these assets, and in which 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, to an extent, from using bearer shares for illicit purposes because any bearer shares 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.

159. 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.

160. 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.

161. The mandatory custodian option is a suggested recommendation by FATF. There is a lack of evidence regarding which of the two current options would have the greatest impact on crime, and there is always potential for criminals to find new ways to evade enforcement. The abolition of bearer shares is, nevertheless, considered the preferred option to secure the full benefits and demonstrate internationally the UK's commitment to the highest possible standards. The mandatory custodian option would not give the full benefits of international recognition for action to combat crime.

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78 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.
79 Companies House internal estimate, 2013.
80 We expect there to be transition costs to software providers associated with updating their standard packages to reflect the changes in the Transparency and Trust and Company Filing proposals. Software companies provided a single cost estimate for the policy proposals collectively rather than broken down by proposal. Discussion of these cross-cutting costs is included in the Company Filing validation IA. Therefore we have not included the costs here to avoid double counting.

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

162. 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. Only 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

163. 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.

164. 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 (£6,000).

C2. Cost to individuals/businesses who own bearer shares: familiarisation, administration and time costs

165. 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 £87,000.

166. 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

167. 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.

168. 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 communication costs

169. 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[81] 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 £32,000 (1089 *£29) (rather than £24,000 under Option 1).

170. 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.

171. The company would not incur communication costs in terms of contacting its bearer shareholders. This cost would not occur under Option 2 because it would still be legal to own bearer shares and therefore it would not be necessary to contact them to inform them of their abolition. There might, however, be communication costs arising from compliance with a mandatory custodian system.

C5. Cost to custodian

172. 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.

173. Ideally, we would want to estimate the following relationship:

174. (Number of bearer shareholders) * (custodian cost per bearer shareholder).

175. In order to generate an estimate, we have pursued the following approach.

176. 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[82]. 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

177. 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.

178. We would assume that these costs could be broadly the same as under Option 1 (and would involve writing a similar number of letters i.e. two letters). This is because the Government

81 http://www.fsa.gov.uk/library/other_publications/banks.
82 http://www.thisismoney.co.uk/money/saving/article-2312085/Barclays-tells-safe-deposit-users-clear-out.html#ixzz2hXLiGQE.

would still need to contact each issuing company directly using a similar mechanism and the issuing company could still need 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 (1,700*1.25). Therefore this transitional cost is £2,100 (see Option 1).

179. 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)

180. We believe that the analytical approach taken in this IA 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.

181. The T*ransparency 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.

182. 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 HMT Impact Assessment). During the consultation on the *Transparency and Trust* paper, which fed into the evidence base underlying this IA, 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 company survey through IFF Research (see Annex A).

183. 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.

184. For the purposes of the Final Stage IA, we built on the existing evidence base with the following:

- an extension to the company survey, consisting of largely qualitative questions; and
- a series of focus groups consisting of businesses and trade associations.

185. The company survey was used to inform the way we treated the data collected in the original survey through a series of in depth interviews with respondents (the methodology and its implications are explained fully in Annex A). The focus groups were used largely to validate the estimates we produced in the Consultation Stage IA.

186. Throughout this process, the evidence gathered from stakeholders has played 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.

187. 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 on the business environment.

188. 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 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.

189. The evidence we have gathered to inform cost estimates in this IA 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 IA. However, to gain a better grasp of how to treat these data we undertook a follow-up survey, which helped us identify where it was reasonable to truncate the data and it largely validated the estimates and approach we used in the Consultation Stage IAs (please see Annex A).

190. We also held a number of business focus groups, which discussed the likely costs of the proposed reforms related to beneficial ownership, corporate directors and front directors[83]. Largely the companies present agreed with our cost estimates, particularly for small companies. However, many companies did comment that compliance could cost considerably more for large and more complex companies if legal and accountancy costs were required. Nonetheless, given that our estimates were weighted by the population, which is 98% small companies, this would bring the estimated costs down so the focus groups broadly validated the figures we presented to them.

191. We are satisfied that the evidence presented here represents the most comprehensive and robust assessment available for a Final Stage IA within the constraints of proportionality with respect to both cost and time.

	Evidence/Data gap	**Why this evidence has not been included in the IA**
Benefits		
B1. 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	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

83 Please see Annex B for the attendance list.

	Number of firms benefiting*effect of measure on business transparency per company* average effect of business transparency on investment	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 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

Table 3: Proportionality analysis of evidence

H. Risks and assumptions

192. The risks and assumptions relevant to this IA are set out below:

Listed companies

193. We are aware that some UK listed companies may use a limited number of bearer shares to facilitate issuing shares on foreign markets.

The link between trust and economic growth

194. 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

195. 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. It is likely this would in effect 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.

Compliance and criminal activity

196. Following standard IA 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.

197. 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 conversion 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.

198. 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.

199. 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 IA, 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.

200. 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

201. 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 G7, G20, FATF and in Europe to encourage other jurisdictions to take similar action.

The potential for collusion

202. 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

203. 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.

204. 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[84]." 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[85]". These issues might well be relevant for non-listed companies also.

205. 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 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.

206. 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 (as noted by the OECD, among others). 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).

207. 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 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.

84 Vermeulen, E. (2013), "*Beneficial Ownership and Control: A Comparative Study - Disclosure, Information and Enforcement*", OECD Corporate Governance Working Papers, No. 7.
85 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.

208. 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 G7, 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.

Companies House development costs

209. 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)

210. The measures in this IA implement international commitments the UK made at the 2013 G8 Summit.

211. We understand that the Better Regulation Framework Manual at time of writing sets out that measures to implement international commitments and obligations are out of scope of One In Two Out, but where there is a clearly prescribed minimum requirement or standard and the UK is implementing in a way that goes beyond this, that the additional burden over and above the minimum would be treated as in scope.

212. The G7 is an international forum that brings together seven global leaders (Canada, France, Germany, Italy, Japan, UK and USA, alongside the EU[86]) to address international issues and tackle the most pressing global challenges. The UK held the 2013 Presidency, and the Prime Minister hosted the annual Summit at Lough Erne in June of that year, where the agreements and commitments made by G8 leaders were set out in a formal Communiqué and documentation.

213. At the 2013 Summit all G8 members agreed a set of Action Plan Principles to prevent the misuse of companies and legal arrangements, and to publish Action Plans setting out the concrete action they would take to implement those Principles. All G8 members published an Action Plan and are moving ahead with implementation.

214. The *Transparency and Trust* measures are drawn from the UK's Action Plan commitments drawn from the Action Plan Principles. Strong action to deliver reform that fully meets these commitments is now the minimum the UK must deliver to meet its international obligations.

215. The G8 obligations are binding in that the UK Government has made a public commitment to implement them; they are politically binding but not legally (or otherwise) binding. The G8 will hold the UK and other members to account in the following ways:

- 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.

86 Prior to 2014, the G8, including Russia.

- 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.

216. Failure to deliver against the 2013 G8 commitments would have significant impact on the UK's international standing within the G8 and more broadly, and would create substantial political embarrassment for the Government. However, the forum of the G8 does not set any minimum legal or other standard for implementation, so we judge these measures to be out of scope for OITO.

217. The UK must now act to deliver against its commitments, consistent with and directly relating to the commitments made in the 2013 G8 documentation. As mentioned, every G8 country has committed to an Action Plan, which sets out how they individually plan to take forward a set of Action Plan Principles agreed by all the G8 Leaders, and indeed reflecting the Communiqué.

218. We consider that the measures the UK will take forward are consistent with and directly in response to the commitments the UK has made. The G8 Action Plan Principles are set out below (though only the relevant provisions have been included). Alongside this the UK has set out a UK Action Plan (also below) to deliver the G8 Action Plan Principles. The UK's delivery of the 2013 G8 commitments will be judged against both of these plans.

219. The UK intends to:

- create and maintain a publicly accessible central registry of company beneficial ownership information; introduce sanctions to individuals and companies that fail to comply; and ensure that this information is readily available to national and international enforcement authorities. This is required to deliver points 1, 2, 7 & 8 of the G8 principles action plan and points 2, 3 & 9 of the UK Action Plan.
- remove the right to issue bearer shares and implement transitional arrangements to remove bearer shares from circulation. This is required to deliver point 5 and support the full implementation of point 1 of the G8 principles action plan and points 2 & 7 of the UK Action Plan.
- restrict the use of opaque arrangements involving company directors. This is required to deliver point 5 and support the full implementation of point 1 of the G8 principles action plan and point 7 of the UK Action Plan.

220. The UK is leading the developments in this area in order to persuade international adoption of these principles and methods. This is required to deliver point 8 of the G8 principles action plan and point 8 & 9 of the UK Action Plan.

221. Points 3, 4, and 6 of the G8 principles action plan and points 1, 4, 5 & 6 of the UK action plan are not directly related to corporate transparency and trust and are therefore being taken forward by other parts of Government, most notably HMT.

222. We consider the measures set out here are the minimum measures necessary to comply with the commitments set out in the G8 Action Plan Principles and UK Action Plan. These measures as a package are required to deliver all the G8 and UK Action Plan requirements on corporate transparency and trust.

223. The measures will be implemented in a way to minimise the additional costs to business. Extensive consultation with business and other interested parties has been conducted to ensure that the measures are implemented in the most effective way, without placing unnecessary additional costs on business.

224. We have carefully considered better regulation principles in developing these measures to implement the UK's international commitments, in accordance with good practice and the Better Regulation Framework Manual. This has included consideration of alternatives to regulation and attempts to minimise the costs to business while ensuring the efficacy of the policy interventions. The evidence underpinning these attempts to evaluate and minimise the costs to business is covered elsewhere in this IA.

225. Although, we consider that 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 to implement the measures as described in this IA has a net direct cost to business per year of £0.12m.

A. G8 Action Plan Principles to prevent the misuse of companies and legal arrangements

226. *Subject to our different constitutional circumstances, and understanding that a one-size-fits all approach may not be the most effective, the G8 endorses the following core principles that are fundamental to the transparency of ownership and control of companies and legal arrangements. These core principles, consistent with the FATF standards, are essential to ensure the integrity of beneficial ownership and basic company information, the timely access to such information by law enforcement for investigative purposes, as well as, where appropriate, the legitimate commercial interests of the private sector.*

227. *The G8 also commits to publish national Action Plans based on these principles that set out the concrete action each of us will take to counter money laundering and tax evasion. To ensure G8 members are held to account for their commitments, 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.*

*1. **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.*

*2. **Beneficial ownership information on companies should be accessible onshore** to law enforcement, tax administrations and other relevant authorities including, as appropriate, financial intelligence units. **This could be achieved through central registries of company beneficial ownership and basic information at national or state level.** Countries should consider measures to facilitate access to company beneficial ownership information by financial institutions and other regulated businesses. Some basic company information should be publicly accessible.*

[…]

*5. **The misuse of financial instruments and of certain shareholding structures** which may obstruct transparency, such as bearer shares and nominee shareholders and directors, should be prevented.*

[…]

*7. **Effective, proportionate and dissuasive sanctions should be available** for companies, financial institutions and other regulated businesses that do not comply with their respective obligations, including those regarding customer due diligence. These sanctions should be robustly enforced.*

*8. **National authorities should cooperate effectively domestically and across borders** to combat the abuse of companies and legal arrangements for illicit activity. Countries should ensure that their relevant authorities can rapidly, constructively, and effectively provide basic company and beneficial ownership information upon request from foreign counterparts.*

B. UK Action Plan to prevent the misuse of companies and legal arrangements

228. The UK is committed to fully implementing the revised Financial Action Task Force standards in order to improve the transparency of the ownership and control of companies and legal arrangements. This is a matter of good corporate governance as well as a means to tackle a wide range of illicit activity. The UK is committed to taking the following actions to do this.

[…]

*2. Ensure the Companies Act 2006 and UK Money Laundering Regulations oblige companies to know who owns and controls them, **by requiring that companies obtain and hold adequate, accurate and current information on their beneficial ownership.***

*3. Amend the Companies Act 2006 to require that this information is accurate and readily available to the authorities through **a central registry of information on companies' beneficial ownership, maintained by Companies House. Consult on whether information in the registry should be publicly accessible.***

[…]

*7. **Review of corporate transparency, including bearer shares and nominee directors,** by the Department for Business, Innovation and Skills. This will start with the publication of a pre-consultation paper before September 2013.*

*8. Support the **Overseas Territories and Crown Dependencies** to publish Action Plans setting out the concrete steps, where needed, to fully implement the Financial Action Task Force Standards.*

*9. **Improve international cooperation** including the timely and effective exchange of basic and beneficial ownership information.*

10. Implementation of the measures will be through, and at the same time as, transposition of the 4th EU Money Laundering Directive and UK Money Laundering Regulations, changes to the Companies Act 2006, as well as through other relevant bilateral and multilateral agreements.[87]

J. Wider impacts

Statutory Equality Duties

87 Company Law is devolved in Northern Ireland. The UK government will work with Northern Ireland and the other devolved administrations to take forward these proposals as appropriate.

229. This policy will primarily impact UK companies. A wider population might derive benefits from the policy as a result of reduced crime or an improved business environment. On analysing the potential impacts[88], we have no reason to anticipate a particular disproportionate impact on the basis of the key measures highlighted in the Equalities Act 2010. We have considered whether the policy might have an adverse or positive impact on equality in relation to the categories set out below.

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

230. This policy aims to mitigate the potential for misuse that bearer share warrants provide. Those affected by the proposal will be bearer share issuing companies and bearer shareholders. We do not consider that people who fall within the above categories should possess a disproportionate holding of bearer shares or be disproportionately impacted by the proposal. We are however unable to quantify this owing to the anonymous nature of bearer shares.

231. There will be a formal requirement for companies to take steps to communicate with their bearer shareholders, which will legally ensure reasonable action is taken to make all bearer shareholders aware of the changes, irrespective of them falling into any of the groups mentioned above. We are aware that there could be narrow, exceptional circumstances where a vulnerable shareholder, perhaps through old age or illness, would nevertheless not be aware of the change or able to take action. We are again unable to quantify this owing to the anonymous nature of bearer shares. We plan to provide for such exceptional circumstances however; bearer shareholders will be entitled to apply to the court for the value held on trust where they can show exceptional circumstances as to why they could not surrender the shares.

Economic Impacts

a. Competition impact test

232. Analysing the measure against the competition questions set out in the guidance did not identify any particular concerns in this area

b. Small and micro business assessment

233. 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.

234. 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.

88 Please see the separate Equalities Impact Assessments for the *Transparency and Trust* package for further discussion.

235. 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”.[89] 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.

236. 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.

237. 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.

238. 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.

239. 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.

240. 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. Given the lack of evidence in this area it is not possible to analyse the impact of the policy on small versus large companies by analysing differences in costs for different sizes of companies.

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

89 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.

Factor	Consideration
Full exemption	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[90]. 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. The RPC advised that we should look to strengthen our analysis of the costs to business. We recognise this concern, in particular around our estimations of the number of bearer shareholders of UK companies, and we have explored this further with Companies House. However, the principle of the bearer share instrument is that no shareholder name is entered on the register. In actuality, in most cases the issuing company makes some record of 'bearer' or 'share warrant to bearer' on the register but there is no consistent reporting of this. This means we cannot use Companies House data to determine the number of bearer shareholders or link this to assumptions including about the size of shareholder, if indeed it is a company (which is not possible to determine). The estimate we have reached uses the average number of total shareholders multiplied by the number of UK bearer share issuing companies. This remains our best estimate given the anonymous nature of bearer shares. However, in the context of companies being used as vehicles for crime, it is still reasonable to consider 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. 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. For this reason, we do not expect small and micro businesses to have to get to stage two of the transitional arrangement (see 'K') as they should find stage one straightforward. Stage two is the only stage of the transitional arrangement which we believe may be particularly burdensome for small and micro businesses.
Partial exemption	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	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.
Temporary exemption	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

90 Companies House analysis, 2013.

	period is in place for all companies to familiarise themselves with changes (see 'K').
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.
Direct financial aid for smaller businesses	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	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	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.

Table 4: Assessment against advised considerations

Justice System

242. Following standard IA methodology this IA assumes 100% compliance with the policy. A Justice Impact Assessment Test has also been completed.

243. 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. The policy is also designed to allow maximum opportunities for compliance within appropriate timeframes.

Court process for cancellation of unconverted bearer shares

244. As mentioned, 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.

245. 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.

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.

Wider social and environmental impacts

Factor	Consideration
Environmental impacts	Preliminary analysis suggests there are no concerns in this area
Health and well-being	Preliminary analysis suggests there are no concerns in this area. Reducing crime should help to improve wellbeing.
Human rights	Following consideration of the policy in relation to human rights[91], we believe any potential impact will be mitigated by the transitional measures that are an inherent part of this package. 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 the registered shares specified in the warrant. 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. 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.
Rural proofing	Preliminary analysis suggests there are no concerns in this area.
Sustainable development	Preliminary analysis suggests there are no concerns in this area.

Table 5: Wider social and environmental impacts

<u>Summary and preferred option with description of implementation plan</u>

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 against some the criteria. This is because Option 2 does not require shareholders to be located and 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.

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[91] Please see the separate memorandum on the European Convention on Human Rights which accompanies the legislation required to take this forwards.

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 (-£1.21m compared with -£9.01m under Option 2). The difference in Net Present Value arises because Option 1 doesn't require the large ongoing costs associated with Option 2. As requested in the RPC's comments on the consultation stage IA we have presented the comparison of options more clearly in the summary table below.

	Option 1 (abolition)	**Option 2 (mandatory custodian arrangement)**	**Which option performs better?**
Benefit			
B1. Benefits to government, individuals and business of a reduction in illicit activities	Unquantified benefit	Unquantified benefit (potentially smaller than Option 1)	Option 1 performs more strongly Under Option 2 criminals should be deterred, to an extent, 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. Law enforcement would also derive benefits in terms of enhanced efficiency and effectiveness of investigations as a result of this paper trail However, Option 2 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
B2. Benefits to companies and individuals from corporate transparency supporting the business environment	Unquantified benefit	No benefit	**Option 1 performs more strongly** In contrast to Option 1 there would be no benefit from increased transparency derived from Option 2. 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	Cost to owners of forgone transferability £6,000 (ongoing) Unquantified cost to forgone	Cost to owners of forgone transferability £6,000 (ongoing)	**Option 2 performs more strongly** Both options perform equally in terms of transferability costs. However, unlike for Option 1, there is no unquantified cost to forgone anonymity under Option 2 as the general public would not have access to information held by the custodian institution

	anonymity		
C2. Cost to individuals/ businesses who own bearer shares: familiarisation, administration and time costs	Familiarisation costs of £87,000 (transition) Administration and time cost of converting shares of £41,000 (transition)	Familiarisation costs of £87,000(transition) No administration or time cost	**Option 2 performs more strongly** Both options perform equally in terms of familiarisation costs. However unlike for Option 1 there are no costs in terms of administration and time for Option 2. This is because it would still be legal to hold bearer shares
C3. Cost to companies who issue bearer shares: financing costs	Unquantified cost	Unquantified cost (expected to be lower as no loss of anonymity impacting negatively on the equity offer)	Option 2 performs more strongly Option 2 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 However since, unlike Option 1, Option 2 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 that wish to issue bearer shares would not be forced to discount their equity or incur costs by so doing
C4. Cost to companies who issue bearer shares: familiarisation, administration and search costs	Familiarisation costs of £23,000 (transition) Administration costs associated with converting the shares (legal charges) of £840,000 (transition) Communication (time and administration) costs associated with	Familiarisation costs of £32,000 (transition) No administration cost associated with changing shares because it would still be legal to own bearer shares	**Option 2 performs more strongly** Option 2 has lowed quantified costs arising from familiarisation administration and communication (£32,000 compared to £1.0m (£23,000+£840,000+175,000) for Option 1) Also Option 1, unlike Option 2, has an unquantified search cost associated with communicating with bearer shareholders. This cost would not occur under Option 2 because it would still be legal to own bearer shares and therefore it would not be necessary to contact them to inform them of their abolition

	the legal requirement to contact bearer shareholders (£176,000) Unquantified cost associated with locating bearer shareholders		
C5. Costs to government of publicising policy changes	Communication costs of £2,000 Companies House development costs of £39,000	Communication costs of £2,000	**Option 2 performs more strongly** Both Options have government communication costs of around £2,000. However Option 1 also has an additional cost associated with Companies House of updating their systems to reflect the prohibition of bearer shares. This cost would not be relevant under Option 2 because bearer shares would not be prohibited
C6. Cost to custodian	No costs	Custodian costs relating to storage of £900,000 (ongoing)	**Option 1 performs more strongly** This is because Option 2 does not incur the substantial custodian costs associated with Option 2 as bearer shares would be prohibited and would therefore not need storing

Table 6: Comparison of costs and benefits

<u>Implementation plan</u>

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 IA reflects the outcome of that call for evidence, as well as the other evidence gathering mechanisms outlined in this document. In April 2014 the government published the response to views received on the *Transparency and Trust* discussion paper, confirming the intention to abolish bearer shares and setting out a more detailed framework for doing so.

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 nine months for the surrender of existing bearer share warrants for conversion to the registered shares specified in the warrant; and
- require companies with bearer shares remaining at the end of the surrender period to apply to court for an order cancelling the remaining shares.

Annex A – Methodology: The IFF Transparency and Trust Survey

A. Background

1. For the purposes of this Final IA, we built on the existing evidence base with the following:

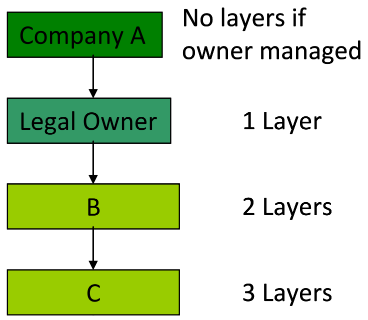
    - an extension to our original company survey, consisting of largely qualitative questions; and
    - a series of focus groups consisting of businesses and trade associations.

2. The company survey was used to inform the way we treated the data collected in the original survey, whilst the focus groups were used largely to validate the estimates we produced in the consultation stage IA.

3. In relation to the original company survey, which was first used to inform the consultation stage IAs, 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 the proposed reforms on all UK companies. Respondents were asked questions to explore the likely cost impact of establishing a central registry of beneficial ownership, transparency around 'front' directors, the prohibition of corporate directors and the disqualification of certain directors.

Sampling

4. To identify the population of interest, we conducted a sample from the Fame[92] database, which is based on Companies House data. Companies were split into a 3x2 grid of quota cells based on corporate structure:



    - simple with 0-1 layers in the ownership chain;
    - reasonably complex with 2-3 layers of ownership (UK-owned, no trusts in the ownership chain); and
    - complex with over 4 layers and/or foreign ownership.

    As well as company size:

    - micro and small (fulfil 2 of 3 from (i) Turnover < £6.5m; (ii) Balance sheet < £3.26m; (iii) Employees < 50); and
    - medium and large (fulfil 2 of 3 from (i) Turnover > £6.5m; (ii) Balance sheet > £3.26m; (iii) Employees > 50).

5. This sampling framework enabled our analysis to identify rigorously how costs would vary by company size and complexity. Ultimately, this shaped the proposed policy so as to minimise the burden on UK companies, whilst maximising the resulting crime reduction and economic growth enhancement.

Data output

6. 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)[93]. The wages used were:

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92 FAME database. 2013. Bureau Van Dijk Electronic Publishing.
93 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

	ASHE wage data	Micro and small companies	Medium and large companies
Senior Management	Chief executives & senior officials	£48.20	£57.18
Middle Management	Corporate managers and directors (excluding chief execs & senior officials)	£18.33	£23.89
Administrative Staff	Administrative & Secretarial Occupations	£10.78	£11.59

Table A1: Wage rates used in the company survey

7. The estimated mean was weighted according to the original Fame sample below, such that more weight was given to cells with a greater number of companies. More specifically, 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. As a result, the overall mean is largely driven by the estimates from 'small, simple' companies.

Weighting grid	Simple	Reasonably complex	Complex	Total
Small / Micro	93.5%	2.9%	1.9%	98.3%
Medium / Large	0.92%	0.28%	0.55%	1.74%
			TOTAL	3,187,112

Table A2: Fame data split by company size and complexity

B. Issues with the original survey

8. 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. In fact, IFF Research explained to BIS that some respondents struggled to answer the questions and some had varying interpretations of the questions.

9. We identified a number of striking distributions across all 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. For instance, the question relating to familiarisation costs for the creation of a register of beneficial ownership information, yielded the following distribution of responses:

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.

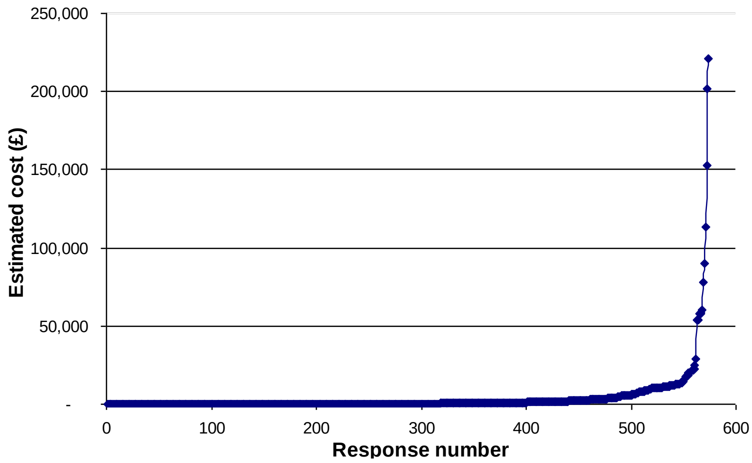

Figure 1: Distribution of responses on familiarisation costs related to beneficial ownership (people with significant control).

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

Table A3: Familiarisation costs related to beneficial ownership (people with significant control)

10. 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 analysis of these respondents showed no relationship between cost[94] and size (based on turnover, employees and assets) and complexity (based on the number of layers of share ownership).

11. If we compare the cost estimates produced by the present survey to other comparable cost estimates, they are substantially higher:

Source	Cost	Cost estimate per company	Company Survey raw mean
Companies House[95] - Filing Requirements	Familiarisation	20 minutes = £6[96]	£1087 (Beneficial Ownership Familiarisation)
PWC – Admin Burdens Exercise[97]	Returning a form to Companies House	£12.39[98]	£160 (Annually providing information to Companies House)

Table A4: Cost estimate comparisons

C. The updated evidence base for the Final Stage Impact Assessment

12. IFF Research conducted a follow-up survey with 43 of the 574 respondents to interrogate their original answers and to identify whether their answers would change in the light of new policy detail. Although the follow-up survey used a relatively small sample, IFF Research was able to conduct in depth interviews with the respondents from the original survey.

94 Although there was a slight tendency for those giving high responses to be 'large' – around 60% were.
95 Detail in the cost benefit analysis within consultation on Companies House Filing Requirements.
96 The wage cost used was £19 – the mid point between the median wage and the wage of a company director
97 This study excluded policy costs, which are typically ten times the admin costs
98 Uprated from 2007 prices to 2013 prices

13. We specifically targeted interviews at the respondents who gave either zero, low (under £5) or high (top 10%) quantitative estimates in the original survey. In total, we received 31 responses to the beneficial ownership questions and 12 responses to the corporate directors questions. Across all the questions we aimed for roughly a 50:50 split between 'high' and 'low' respondents.

14. Ultimately, the research findings guided us in developing the methodology for this Final IA and determined the way in which we treated both the *low* and *high* respondents.

15. For the reasons set out below, the new survey indicated the original survey questions lacked the specificity required to elicit fully informed answers consistently. **We believe these issues have had an effect on the robustness of the responses and therefore on their overall suitability for <u>unqualified</u> use in our analysis of the costs**. The issues we identified with the survey are detailed below for both the beneficial ownership policy and the corporate directors policy. We faced the same issues in the survey with both policies so it is worthwhile discussing them jointly.

<u>Reasons companies gave high wage cost estimates</u>

16. Reasons included :
    - Misinterpretation of the questions (e.g. provision of annual cost estimates rather than for a single procedure. This gave estimates which were many times larger than they should have been).
    - Companies provided initial upper estimates, which they expected to fall over time.
    - Double counting (e.g. companies including compliance costs in their familiarisation cost estimate as well as reporting it separately).
    - Reporting the total number of hours for all staff rather than a break down by staff level. This raised cost estimates substantially if the staff hours were recorded as senior staff time with their considerably higher wage relative to admin staff time for instance.

17. In addition to the four types of mistakes we commonly encountered from respondents in the original survey, respondents often revised down their original estimates when they were given new policy information:

    - 54% (of the 24 companies which were asked how their estimates would change) revised down their estimates on beneficial ownership from an originally 'high' estimate.
    - 29% (of the 17 companies which were asked how their estimates would change) revised down their estimates on corporate directors, whilst 65% stood by their original 'high' estimate.

18. This finding reinforces our use of the four types of mistakes to inform our treatment of the data to remove a number of the extreme values. If <u>all</u> companies had revised down their estimates, we might have considered removing more of the outliers but have adopted a more moderate approach here.

19. We by no means considered <u>all</u> the 'high' responses received in the first company survey invalid. However, in the light of the above we targeted the removal of high estimates primarily from 'small simple' companies, as described below - Table 6 shows the highest estimates we used were still in most cases several thousand pounds for 'large complex' companies. Although the second company survey did not entirely determine how we treated the data, it did indicate to us that a proportion of cost estimates were plausible and some implausible.

Quotes from 'high cost' respondents:

In terms of familiarisation with the beneficial ownership proposals, once companies were given new policy detail they revised down their estimates considerably. One respondent, who previously estimated it would take one senior manager five hours and £10,000 in additional (legal) costs said:

That would obviously take less if it could all be done by this [13 pages of guidance for familiarisation] *and less digging had to be done and to make the explanation up front. Should reduce it by at least 25% if I have to give a number.*
[micro/small, simple structure]

Similarly, a representative from small complex company revised compliance cost estimates down substantially after new policy information made the respondent realise compliance would be less onerous than originally expected:

Those times and costs would go down considerably. Down by 90% because all the work's done for you. They're just saying 'we're here, hi!' [micro/small, complex structure]

Reasons companies gave low wage cost estimates

20. Reasons included:
    - Companies misunderstood and thought the reforms were not relevant to their company (particularly for beneficial ownership) so incorrectly assumed they would not undergo any cost for familiarisation or compliance.
    - Difficulty in answering the hypothetical questions (e.g. most companies answering the corporate directors questions did not have a corporate director, so chose to give low responses).

21. In the light of new policy information, 79% (of the 19 companies which were asked how their estimates would change) did not revise their estimates on *beneficial ownership*, whilst the remaining 21% revised up their original 'low' estimate.

22. By contrast, 63% (of the 19 companies which were asked how their estimates would change) revised up their estimates on *corporate directors*, whilst the remaining 37% stood by their original 'low' estimate.

Quotes from 'low cost' respondents:

In the case of companies familiarising themselves with the beneficial ownership proposals, a typical response from a respondent who already knew their company's beneficial owner and understood the associated principles was:

'We have 2 shareholders with 50% share each, they're both directors of the company, they both live together and one of them is me. So we are both well aware of the changes and we don't really need to do much else.' [micro/small, reasonably complex structure]

Another comment related to a small simple company responding to a request was:

'We're only a small private owned company with a couple of shareholders so beneficial ownership is not really much of an issue. It would be one person (i.e. me) writing a letter I suppose, or responding to an email - no systems or infrastructures envisaged.' [micro/small, simple structure]

Business Focus Groups

23. Alongside the follow-up company survey we also held a number of focus groups with around 30 companies and 6 business representative organisations (listed in Annex B), which together represent at least 240,000 companies and many hundreds of thousand employees. These groups were orientated around validating or disproving the estimates we provided in the consultation stage IAs.

24. In the case of the beneficial ownership, of the six distinct types of cost, five of them were largely validated by the groups. Collation, processing and storage costs were only partially validated because some companies thought if paper records were required costs could be higher. Although the attendees found it difficult to place an accurate figure on how much it would cost them to follow a certain procedure, in general they thought our estimates seemed to be reasonable for small simple companies (around 94% of the population) but costs could be considerably higher for larger and more complex companies. Given that the figure was already weighted by the size and complexity of the company (as detailed below), we considered it to be consistent with the types of comments the groups made.

25. As regards the proposals related to corporate directors, a number of companies thought that we had focussed our analysis of the costs too heavily upon the procedures and processes they would have to follow. The consensus was that the majority of the costs would come from the legal advice and recruitment costs associated with the proposals so we included them in the final IA.

D. Methodology for the Final Stage Impact Assessment

26. Despite its flaws, the original representative survey provides the most comprehensive dataset available, and we believe there is value in processing it to produce realistic and duly qualified cost estimates. The results from the original company survey, particularly at the upper end of the distribution were surprising. Firstly, they didn’t fully accord with the discussions we had with stakeholders and secondly it was not clear why the estimates were so high.

27. For the Consultation Stage IA we also adopted a truncated mean approach (i.e. using only feasible values in the mean calculation) to adjust for extreme values. The RPC commented that some further analysis around how the estimates differ if the data were processed differently would be informative, so we have refined our approach.

28. For this Final Stage IA, we were able to gather more evidence from an additional survey and business focus groups to build on the evidence we already had. Indeed, the analysis and evidence gathering for this IA have been in development since July 2013 and we have pursued every relevant evidence source fully. The new evidence enabled us to truncate the data on the basis of this new information. For instance, the second company survey suggested that the extreme ‘high’ cost estimates commonly suffered from double counting and misinterpretation. Put simply, these extreme estimates were found to be unfeasibly high and not appropriate to include in the dataset. This validated our approach of processing the data to arrive at realistic estimates.

29. Therefore, we have truncated the mean (i.e. used only feasible values in the mean) to adjust for extreme values. Truncation is a statistical technique which is commonly applied to survey data. On this occasion, we utilised a more robust technique to identify where to truncate and we truncated a lower proportion of the data than in the consultation IA and we utilised a more robust technique to identify where to truncate.

Treatment of high wage cost estimates

30. It is necessary to exclude implausible or unverifiable estimates at the opposite end of the distribution. Similarly to the consultation IA, we used a truncated mean for each survey question relating to costs. However, on the basis of the new evidence we gathered for this IA, we have revised our truncation method as follows:

    iii) We trimmed the weighted values (rather than the unweighted values, as per the Consultation IA) to target more effectively the implausibly high estimates, which were biasing our estimate of the mean upwards. This also enabled us to trim a lower share of the data relative to our previous approach in the consultation IA.

iv) We used a robust statistical technique (based on analysing the coefficient of variation[99]) to identify the specific point at which to truncate the mean.

31. To explain (i) further, as detailed above, each observation in the sample was weighted according to how commonly its company type (based on the 3 x 2 grid in table 2) was seen in the population. As a result, an estimate given by a small simple company was given a much greater weight than one given by a large complex company. Once these weighted values are totalled and divided by the number of observations, this ultimately produces a mean that is representative of the whole population.

32. By trimming weighted values, we are able to remove most efficiently the observations, which are distorting the mean upwards. For instance, if a small simple company were to offer a cost estimate of £1,000 because that type of company is given a large weighting, this single response would drag up the mean substantially. On the basis of our second company survey, the relatively high responses were called into question for the reasons detailed above. It would therefore be sensible to remove the responses, which were incorrectly raising the mean beyond a feasible value. Moreover, adopting this approach helps to minimise the number of observations that are removed from the dataset.

33. With regard to (ii), for each quantitative question we plotted the coefficient of variation for each potential trim, as shown below for the cost of removing and replacing a corporate director. Adopting this approach rather than simply eyeballing the distributions to identify where to trim, gives us a robust objective rule which is founded upon minimising the sampling error. Trimming on a purely statistical basis, we should trim up to the lowest coefficient of variation (i.e. the global minimum). However, the estimated means produced on this basis produced results which were inconsistent with the costs we would expect based on our latest focus groups and company survey.

34. For this reason, we have adopted a second trimming approach, which trims after the next substantive fall in the coefficient of variation (i.e. the next lowest local minimum). This allows us to arrive at an estimate, which is more consistent with the figures which were validated by industry in our focus groups and company surveys. In the chart below, the vertical red line on the left is the suggested trim based on the first method (1%) and the vertical red line on the right is the suggested trim based on the second method (8%).

[99] The coefficient of variation is a measure of sampling error, which takes account of the size of the estimate, giving a relative measure of precision. It is calculated as the standard error divided by the mean. Lower figures imply a more precise estimate of the mean. Standard errors have been calculated taking proper account of the fact that we are using a weighted and truncated mean, such that the highest observations still contribute to the standard error.

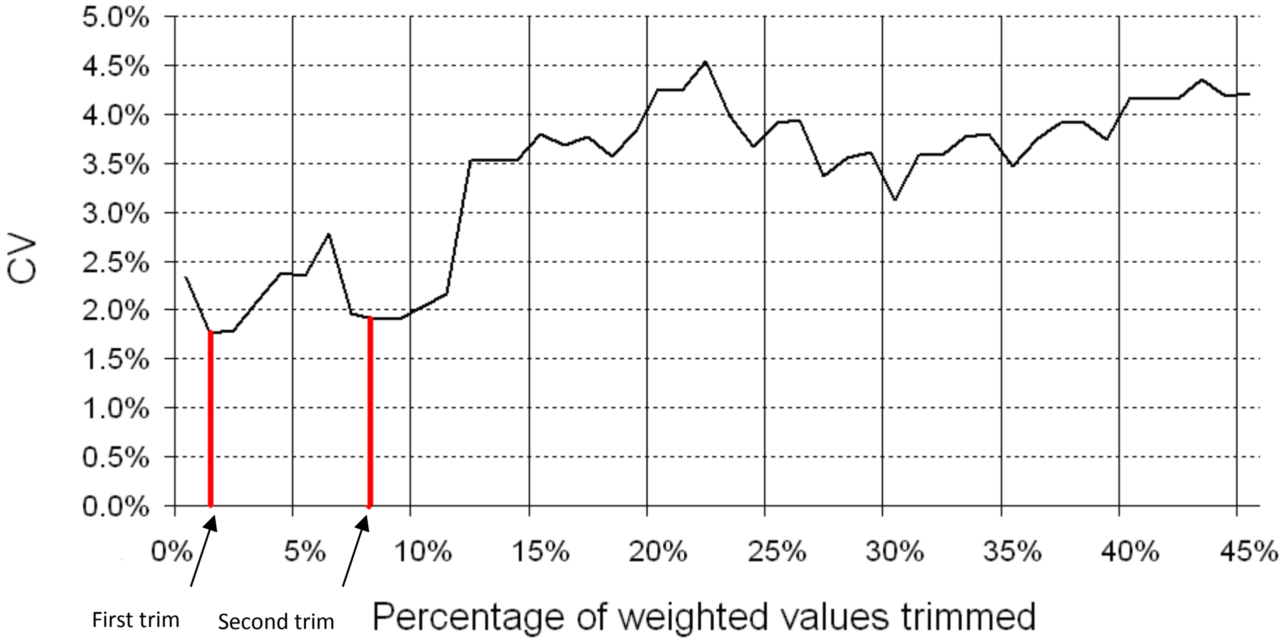

Figure 2: Coefficient of variation chart for the cost of removing and replacing a corporate director

35. To provide some sensitivity analysis around these estimated means, we used the following estimates:

- Low: Mean from the second trimming approach (local minimum).
- High: Midpoint between the two trimming approaches.
- Best: Mean from: (Percentage of remaining data after second trim x Second trimming approach mean) + (Percentage of data trimmed under second approach x Mean from first trimming approach).

For instance, the best estimate in the case of removing and replacing a corporate director was calculated as follows: (93% x £58) + (7% x £191) = £67. This essentially assumes that for 93% of companies, £58 would be a reasonable estimate whilst £191 would be appropriate for the remaining 7%. The low estimate would be £58 (i.e. the second trim) and the high estimate would be £125, calculated as a mid-point between the first and second trims.

36. To explain our thinking further, based on the results of the second company survey and the focus groups, we felt we had to trim the data to arrive at reasonable cost estimates. Of the two trimming approaches we used, the estimates derived from the first trim were not reasonable based on the wider evidence we gathered. For this reason we applied the above sensitivity analysis, which uses both trims, to arrive at a range of estimates that fitted closely with the discussions we had with business.

37. The table below displays where the coefficient of variation led us to trim under the two chosen methods. We also provide the cost estimates for these two methods in addition to the low, best and high wage cost estimates, used in the calculations for this IA. These estimates are in line with the BIS evaluation of the Companies Act 2006[100] in which 33% of the companies surveyed spent under 10 hours in total complying with the whole Companies Act over the course of three years (at the very most around £480 in wage costs).

100 http://www.bis.gov.uk/assets/biscore/business-law/docs/e/10-1360-evaluation-companies-act-2006-volume-1.pdf

Cost	First trimming approach		Second trimming approach		Wage cost estimates		
	Trim	Cost	Trim	Cost	Low	Best	High
Familiarisation with the beneficial ownership reforms	6%	£111	13%	£48	£48	£56	£80
Identifying and collecting information about the beneficial owner.	1%	£45	8%	£5	£5	£9	£25
Responding to a request about your beneficial ownership.	4%	£35	13%	£7	£7	£11	£21
Collation, process and storage of beneficial owners data	1%	£53	9%	£9	£9	£13	£31
Updating beneficial ownership information annually	4%	£42	14%	£9	£9	£14	£26
Providing beneficial ownership information to a central register annually.	3%	£40	14%	£9	£9	£13	£24
Familiarisation with the proposal to prohibit corporate directors.	3%	£43	13%	£8	£8	£13	£26
Removing and then replacing a corporate director.	1%	£191	7%	£58	£58	£67	£125
Removing or updating a corporate directorship.	1%	£110	9%	£32	£32	£39	£71
Disruption/reputational damage to companies with corporate directors after prohibition	1%	£290*	1%	£95	£95	£193	£290
Disruption/reputational damage to companies which are corporate directors after prohibition	1%	£260*	1%	£11	£11	£135	£260

**For the costs related to disruption and reputational damage for corporate directors we adopted a different methodology. Under the first trimming approach we trimmed the weighted data with any zeros re-coded to the lowest recorded value; this formed the 'high' estimate. Under the second trimming approach we trimmed the weighted data including any zero values; this formed the 'low' estimate. The 'best' estimate was calculated as a midpoint between the two.*

Table A5: Wage cost estimates and trimming positions

38. However, as noted above, we trimmed on the basis of weighted cost estimates. Since around 94% of companies were 'small, simple', any estimate from a company of this type would be weighted relatively heavily. As a result, if a 'small, simple' company gave a relatively high cost estimate, combined with their large weighting, their estimate would be more likely to appear at the top of the distribution. It would therefore make it more likely to be trimmed from the dataset as an extreme value.

39. Our *a priori* knowledge of the likely costs as well as our evidence base (second company survey, business focus groups and consultation) suggested that, particularly for 'small, simple' companies, costs should be relatively low compared with larger more complex companies. This was largely because compliance would be far more straightforward. For this reason, it was deemed plausible that any 'small, simple' estimates at the upper end of the distribution were less reliable and hence correctly caught by the trimming methodology. By contrast, where possible, we avoided removing estimates from larger, more complex companies because compliance could be considerably more time consuming.

40. The table below compares the maximum cost estimates provided by ‘small, simple’ and ‘large, complex’ companies, when the data are untrimmed and at the second trimming point[101]. To explain further, iteratively trimming one percent of the data at a time will gradually remove the highest weighted values. As more data points are removed this reduces the threshold level for the maximum estimate, which feeds into the mean. However, the impact will differ by company type because generally the companies with the largest weighting (i.e. ‘small, simple’) will have their highest cost estimates trimmed first.

41. It is clear to see that at the second trim, the maximum allowed estimate for ‘small simple’ is substantially reduced. For instance for beneficial ownership familiarisation, the maximum untrimmed estimate for a ‘small simple’ company was £48,200 but after trimming, the maximum allowed estimate was £59. The maximum estimate for a ‘large complex’ company falls substantially but remains almost 100 times as large as the ‘small simple’ estimate. More specifically, it falls from £88,244 to £5,718.

42. This demonstrates that under our trimming method, we are primarily targeting the removal of the ‘high’ estimates from ‘small simple’ companies. However, we are not removing proportionately as many of the estimates from ‘large complex’ companies, for which costs might be substantially higher. This is in line with the evidence we gathered from the business focus groups and the follow-up company survey.

Cost	**Untrimmed**		**First Trim**		**Second Trim**	
	Max recorded estimate		**Max allowed estimate**		**Max allowed estimate**	
	'Small simple'	'Large complex'	'Small simple'	'Large complex'	'Small simple'	'Large complex'
Familiarisation with the proposed beneficial ownership reforms	£48,200	£88,244	£236	£13,447	£59	£5,718
Identifying and collecting information about the beneficial owner.	£1,475	£6,407	£386	£6,407	£22	£2,287
Responding to a request about your beneficial ownership.	£5,398	£4,864	£96	£4,864	£12	£1,372
Collation, process and storage of beneficial owners data	£8,819	£34,678	£3,889	£34,678	£138	£18,230
Updating beneficial ownership information annually	£2,699	£4,735	£96	£4,735	£14	£1,372
Providing beneficial ownership information to a central register annually.	£12,050	£5,248	£96	£5,248	£12	£1,946
Familiarisation with the proposal to prohibit corporate directors.	£12,050	£34,714	£145	£2,765	£15	£1,394
Removing and then replacing a corporate director.	£5,398	£24,811	£964	£24,811	£145	£5,718
Removing or updating a corporate directorship.	£2,892	£24,811	£578	£24,811	£48	£8,107
Disruption/reputational damage to companies with corporate directors after prohibition	£80,000	£50,000	£1,000	£50,000	-	-
Disruption/reputational damage to companies which are corporate directors after prohibition	£7,000	£15,000	-*	£15,000	-	-

**Applying the same method as for the other questions, in this case, there were so few responses that trimming just 1% of the data removed all ‘small, simple’ values. As a result, we only applied one trim.*

Table A6: Maximum allowed estimates under trimming method

43. To demonstrate the impact of trimming on the means for different company type, for illustrative purposes, table 8 provides the means for ‘small simple’ and ‘large complex’ companies. Naturally, by

[101] We provide only the data for the second trim for illustrative purposes because this shows the largest change from the untrimmed data.

trimming, the means for both company types fall. However, the mean for ‘small simple’ companies falls substantially more than for ‘large complex’ companies. For instance, the mean familiarisation costs related to beneficial ownership fall from £1,098 to £46 for ‘small simple’ companies. By contrast, for ‘large complex’ companies, the mean falls from £1,858 to £946. This demonstrates the types of mean we arrive at under the trimming approach compared to the means we would arrive at without trimming.

Cost	Untrimmed		First Trim		Second Trim	
	Mean		Mean		Mean	
	'Small simple'	'Large complex'	'Small simple'	'Large complex'	'Small simple'	'Large complex'
Familiarisation with the proposed beneficial ownership reforms	£1,098	£1,858	£133	£1,102	£46	£946
Identifying and collecting information about the beneficial owner.	£70	£296	£41	£296	£5	£228
Responding to a request about your beneficial ownership.	£181	£204	£39	£204	£7	£156
Collation, process and storage of beneficial owners data	£88	£350	£55	£350	£11	£230
Updating beneficial ownership information annually	£144	£205	£45	£205	£10	£171
Providing beneficial ownership information to a central register annually.	£214	£205	£43	£205	£10	£172
Familiarisation with the proposal to prohibit corporate directors.	£252	£542	£53	£219	£7	£191
Removing and then replacing a corporate director.	£335	£635	£205	£635	£73	£442
Removing or updating a corporate directorship.	£171	£725	£120	£725	£32	£495
Disruption/reputational damage to companies with corporate directors after prohibition	£1,490	£515	£70	£515	-	-
Disruption/reputational damage to companies which are corporate directors after prohibition	£120	£354	-*	£354	-	-

**Applying the same method as for the other questions, in this case, there were so few responses that trimming just 1% of the data removed all ‘small, simple’ values. As a result, we only applied one trim.*

Table A7: Estimated means under second trimming method and untrimmed

<u>Treatment of zero wage cost estimates</u>

44. It is also necessary to consider how to treat zero values. A large number of survey respondents answered that there would be zero costs arising, for example from the proposed policy changes, as detailed in section C. 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. For this reason, we re-coded these observations such that they were set to the minimum recorded positive estimate. For instance, if the minimum cost estimate any company in the sample gave was £5, all zero responses would be re-coded to £5. This is a reasonable approach, which reflects the assumption that all companies would have to undergo some cost. It also minimises the bias to the dataset, which we would otherwise have introduced by re-coding the values to an higher value, which is not supported by any evidence. This will raise the estimate mean cost relative to simply including zero cost values in the calculation of the mean.

45. The main benefit of not removing the zero values from the sample as we did in the consultation IA is that we are not losing such a substantial number of observations from the sample. Since we need to trim at the top end of the distribution, also removing the zero responses from the bottom end would

dramatically reduce the sample size. As shown in the below table, there was considerable variation in the number of zero responses for each question but on average around 30% of observations were zero.

	Number of zero observations	Zero observations as % of all observations
Cost of company familiarisation with the beneficial ownership reforms	67	12%
Cost of identifying and collecting information about the beneficial owner.	387	67%
Cost of responding to a request about your beneficial ownership.	185	32%
Cost of collation, process and storage of beneficial owners data	162	28%
Cost of updating beneficial ownership information annually	119	21%
Cost of providing beneficial ownership information to a central register annually.	76	13%
Cost of ensuring familiarising with the proposal to prohibit corporate directors.	186	32%
Cost of removing and then replacing a corporate director.	147	26%
Cost of removing or updating a corporate directorship.	165	29%
Cost of disruption/reputational damage to companies with corporate directors after prohibition	534	93%
Cost of disruption/reputational damage to companies which are corporate directors after prohibition	551	96%

Table A8: Zeros observations in the sample

<u>Treatment of additional cost estimates</u>

46. 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 Research 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.

47. In the follow up study, IFF Research further interrogated the additional costs. Companies generally considered these costs to arise from legal and accountancy advice for the beneficial ownership questions and from recruitment for the corporate directors questions. In the light of new evidence, the majority of companies stood by their original estimate but similarly to the wage cost estimates, a number of companies gave comments that cast some doubt over the validity of the highest estimates. The main issues we noticed were:

- some companies commented that their additional cost estimates were very much a ‘worst case scenario’;
- some companies mentioned that they might not in fact incur additional costs; and
- a few companies noted that on reflection they may have included some staff time in their additional cost estimates – meaning there was some double counting.

48. For instance, one 'high cost' additional cost response, came from a company which previously estimated additional costs of £5,000. In the second survey they revised their answer, no longer feeling that it would cost their company anywhere near this, and would be more likely to cost them around £100. This was because, on further discussion, they felt that they would not need to incur legal fees for this particular task.

> *'I think the most likely outcome is that the cost will be negligible by which I mean less than £100 and it would be an awful lot to take it £5,000 to be honest on the basis that there's no cost in terms of fees, so we're only talking about internal time.'* [medium/large, simple structure]

49. In the case of additional costs for the removal of a corporate director, for which cost estimates varied from, £5,000 to £100,000, one company considerably revised their estimate:

> *'On reflection, that feels a little bit high really. Maybe I didn't quite understand the question. I can't possibly think how I got to these figures.'* [medium/large, simple structure]

50. On this basis, it seemed sensible to truncate the dataset using the same method that we applied to wage costs. The only difference in method for our treatment of additional costs was the inclusion of zero values. In this case, we consider it an entirely valid response for a company to state that it would not undergo optional additional costs because it could comply with the proposals using in house resources.

51. The table below details where we chose to trim and the resulting estimated mean. These estimates are in line with the BIS evaluation of the Companies Act 2006[102] in which 64% of the companies surveyed spent under £500 in total on additional costs to comply with the whole Companies Act over the course of three years.

	First trimming approach		Second trimming approach		Additional cost estimates		
Cost	**Trim**	**Cost**	**Trim**	**Cost**	**Low**	**Best**	**High**
Company familiarisation with the proposed reforms	4%	£111	12%	£25	£25	£36	£68
Identifying and collecting information about the beneficial owner.	1%	£65	6%	£15	£15	£18	£40
Responding to a request about your beneficial ownership.	1%	£87	6%	£15	£15	£19	£51
Collation, process and storage of beneficial owners data	1%	£37	4%	£11	£11	£12	£24
Updating beneficial ownership information annually	1%	£113	4%	£27	£27	£30	£70
Providing beneficial ownership information to a central register annually.	1%	£63	4%	£21	£21	£22	£42
Familiarisation with the proposal to prohibit corporate directors.	1%	£76	7%	£11	£11	£16	£43
Removing and then replacing a corporate director.	1%	£376	6%	£77	£77	£95	£226
Removing or updating a corporate directorship.	1%	£182	6%	£39	£39	£47	£110

Table A9: Additional cost estimates and trimming positions

102 http://www.bis.gov.uk/assets/biscore/business-law/docs/e/10-1360-evaluation-companies-act-2006-volume-1.pdf

Annex B: Focus Groups Attendance List

1. As set out in Annex A, alongside the follow-up company survey we also held focus groups with around 30 companies and 6 business representative organisations which together represent at least 240,000 companies and many hundreds of thousand employees. These focus groups were orientated around validating or disproving the estimates we provided in the consultation stage IAs.

2. The first focus group was aimed at business, particularly small and medium sized businesses. To reach individual businesses, we asked the representative bodies to encourage their members to attend. We also worked with Companies House to invite businesses; the list below reflects those who were ultimately able to come to the discussion.

3. The second focus group was aimed at business representative bodies. We invited a range of bodies to attend, the list below reflects those who were ultimately able to come to the discussion and where possible we engaged though alternative means with those who were not able to attend.

Companies in attendance	Business representative organisations in attendance
Abell Morliss International	ICSA - Compliance
Armess	BCC
Assoc of Company Registration Agents	ICAEW
Bank of America Merrill Lynch	Law Society
Broadhead Accountants	ICSA Software International
Capita Asset Services	ICSA - Customer Services
Capita Asset Services	
Centrica PLC	
Charles Russell LLP	
Chettleburgh's Ltd	
Company Registrations Online	
Creditsafe	
Dun and Bradstreet and BIPA	
Entone Group	
Experian	
Jordans Trust Company Ltd	
LegalinX-7Side	
MSP Secretaries	
Naylor Wintersgill	
Penfold & Redstone Ltd	
PWC Tax	
RBJ Tax & Accountancy Services	
Slaughter and May	
Stanley Davis & Co.	
The London Law Agency Ltd	
Thomson Reuters	
Thrings Solicitors	
Ward Williams	
Wilder & Coe Ltd	

Annex C: Sensitivity Analysis

1. As requested by the RPC we have conducted a sensitivity analysis around the assumption that there are 3000 bearer share issuing companies. The number of UK companies who have issued bearer sharers (1,233) is multiplied by the average number of total shareholders per average UK company (2.3) which gives a total estimated number of bearer shareholders of just under 3,000.

2. The upper and lower bounds to the sensitivity analysis are derived from the response to a letter issued by BIS to bearer share issuing companies. Out of 552 responses all except 7 reported up to 100 bearer shareholders and the majority (299 responses) reported at least 1. Therefore the upper bound estimate is 100 bearer shareholders and the lower bound estimate is 1 bearer share holder. These sensitivity analysis associated with these estimates is presented in the table below

Cost	Original calculation (best estimate)	High estimate (BE*/2.3)*100)	Low estimate(BE/2.3)
C1. Cost to individuals/ businesses who own bearer shares: anonymity and transferability costs	3000*£9.50*0.21= **£6,000**.	(£6,000*100)/2.3=**£261,000**	£6,000/2.3=**3,000**
C2. Cost to individuals/ businesses who own bearer shares: familiarisation, administration and time costs	Familiarisation costs (3000 * £29).= 87,000 Administration costs (3000*(£6+£7.50))=£41,000 Total= (£87,000+42,000) **£128,000**	(£128,000*100)/2.**3=5.6m**	£128,000/2.3=**56,000**
C4. Cost to companies who issue bearer shares: communication costs (sensitivity analysis does not include familiarisation and administration)	Cost of placing advert in the Gazette (117,000)+ Cost of sending communication to stakeholders = 3000*13=£59,000 **Total = 176,000**	Cost of placing advert in the Gazette (117,000)+ (59,000*100)/2.3=**2.6m** **Total = 2.7m**	Cost of placing advert in the Gazette (117,000)+ (59,000)/2.3=**26,000** **Total = 143,000**
C5. Cost to custodian	**0**	(0*100)/2.3=**0**	0(/2.3)=**0**

Table 1: Option 1: Abolition of bearer shares

Cost	Original calculation (best estimate (BE))	High estimate (BE*/2.3)*100)	Low estimate (BE/2.3)
C1. Cost to individuals/ businesses who own bearer shares: anonymity and transferability costs	3000*£9.50*0.21= **£6,000**.	(£6,000*100)/2.3**=£261,000**	£6,000/2.3=**3,000**
C2. Cost to individuals/ businesses who own bearer shares: familiarisation, administration and time costs	<u>Familiarisation costs</u> (3000 * £29).= 87,000	(£87,000*100)/2.3= **£3.8m**	£87,000/2.3=**38,000**
C4. Cost to companies who issue bearer shares: communication costs (sensitivity analysis does not include familiarisation and administration)	**0**	(0*100)/2.3=**0**	0(/2.3)=**0**
C5. Cost to custodian	3000*£300= £0.9m	(£0.9m*100)/2.3= **39.1m**	(£0.9m*100)/2.3=**391,000**

Table 2: Option 2: Mandatory custodian arrangements

3. The sensitivity analysis shows that the costs of Option 2 are highly sensitive to the number of bearer shareholders and this is driven by custodian costs. Assuming there are 100 bearer shareholders per company leads to ongoing costs of £39m.

<u>Annex D: Detail of the Procedure and Timeframe of Policy Option 1</u>.

1. As set out in the main text, based on the responses we received to the Transparency and Trust discussion paper the government's position is that nine months is an appropriate duration for the surrender period for bearer shares[103].

2. It is important to act expeditiously to secure UK compliance with international obligations.However, given the anonymous nature of bearer shares we understand the challenges of a company being able to identify their bearer shareholders to inform them of the changes. We therefore propose, in the lead in to and during a two month period between Royal Assent and the commencement of the policy, to encourage companies to begin communicating with their bearer shareholders to inform them about the impending changes and to encourage them to surrender their warrants ahead of the changes, where their articles permit this.

3. We also propose to set out in legislation the steps companies must take within the first month of the policy coming into force, and again in the eighth month (of the nine month period) if there are still bearer shares remaining. This formal requirement for communication will follow the lead in period described above and will legally ensure reasonable action is taken to make bearer shareholders aware of the changes, in order for them to take swift action to surrender their warrants.

4. The steps that companies must take to communicate with their bearer shareholders would be:

    a. giving notice of the impending changes using the usual method of shareholder communication such as is used to give notice of, for example, AGMs or dividends;
    b. placing a notice of the impending changes in the Gazette; and
    c. placing a notice of the impending changes in a prominent position on their website (where there is one) throughout the duration of the conversion period.

5. Restrictions on the bearer shares would also be introduced within the nine month period. Bearer shareholders would no longer be able to vote or receive dividends, or to trade the share warrant. We consider this would incentivise bearer shareholders to take swift action, as their rights are available to them on the surrender of their share warrants for conversion to registered shares, and incentivise companies to take swift action, to avoid the potential process of imposing the restrictions. It will also avoid a situation where bearer shareholders could continue to trade their shares throughout the nine months. Restricting this infinite transferability during the conversion period means the prescribed steps companies must take to communicate with their shareholders have a better chance of being effective.

6. Measures would need to be in place to deal with any bearer shares that remain at the end of the nine month surrender period. We intend that companies with bearer shares remaining will have a further three months to apply to the court for an order cancelling remaining bearer shares.

7. Moreover, in implementing the present reforms, 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.

8. If bearer shares are prohibited, some current users are likely to seek alternative legitimate means of maintaining their interests in companies while protecting their identity. Notably, this could include using an intermediary to hold the legal title to the shares, collect the dividends and vote on their behalf. From a policy perspective, we are satisfied that this meets our transparency standards. Use of intermediaries removes the infinite transferability afforded by bearer shares and provides some paper trail for law enforcement. In addition, individuals with an interest in more than 25% interest of a

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103 Analysis in this Impact Assessment is modelled on a period of 12 months.

company's shares or voting rights will be required to be disclosed on a register of beneficial ownership (and see related IA in the *Transparency and Trust* package), limiting the scope for obfuscation.

Annex E – A theoretical and empirical framework linking trust, transparency and growth

1. 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[104]. 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)[105] 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[106] were five times higher for the least trusted supplier.

2. There is also a known link between overall economic growth and trust,[107] with the literature commonly identifying a significant positive relationship between the two. This emerges because trust motivates investment, innovation and more broadly entrepreneurship[108]. 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)[109] 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)[110] 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.

3. 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)[111] 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),[112] 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.

4. Analysis of U.S. states by Dincer and Uslaner (2010)[113] 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

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104 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.
105 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
106 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.
107 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 .
108 However, the literature must carefully control for reverse causality, i.e. how far high growth countries are generally more trusting.
109 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
110 Zak, P.J. and Knack *(2001)'Trust and growth'* S Economic Journal, 111, 295–321.
111 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
112 Horváth, R. (2013) *Does trust promote growth?* (2013) Journal of Comparative Economics, Elsevier, vol. 41(3), pages 777-788.
113 Dincer and Uslaner (2010) *'Trust and Growth' Public Choice*

might otherwise have expected it to be restricted to jurisdictions with weaker institutional infrastructure and greater reliance on knowing and trusting business partners).

5. 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)[114] 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.

6. 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 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.

7. Two notable exceptions are Bjørnskov (2012)[115] and Botazzi et al (2010)[116], 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)[117], 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.

8. Indeed, during discussions with business at a series of focus groups, they largely validated this view:

   > *'If a company knew who was behind the company they were making a deal with, it could save them from making bad decisions'*

   Moreover, one business commented that *Transparency and Trust* might encourage Foreign Direct Investment, if the package makes it easier for overseas companies to see who they are dealing with.

9. 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)[118] 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.

10. By increasing corporate transparency, including through reducing the use of opaque arrangements involving company directors, benefits to trust, and therefore the business environment and potentially economic growth, should be realised.

114 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
115 Bjørnskov (2012) '*How Does Social Trust Affect Economic Growth?*' Southern Economic Journal, Working Paper 06-2
116 Botazzi, L., Da Rin, M. and Hellman, T. (2010) '*The importance of trust for investment'* NBER Working Papers 16923
117 Guiso, L, Sapienza, P. and Zingales, L. (2008) '*Trusting the Stock Market'* The Journal of Finance, Vol 63, Issue 6, pp2557-2600
118 Whiteley, P. (2000). *Economic Growth and Social Capital* Political Studies 48, 443-466.

Title: Transparency and Trust – Opaque arrangements involving company directors **IA No:** BIS BE023 **Lead department or agency:** Department for Business, Innovation & Skills **Other departments or agencies:** Companies House, Insolvency Service, HMT, Home Office, Ministry of Justice, law enforcement agencies	**Impact Assessment (IA)** **Date:** Published 25 June 2014 **Stage:** Final Stage **Source of intervention:** International **Type of measure:** Primary legislation **Contact for enquiries:** Email: Transparencyandtrust@bis.gsi.gov.uk Tel: 0207 215 1848
Summary: Intervention and Options	**RPC Opinion:** GREEN

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
-£45.08m	-£49.97m	£4.48m	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.

Opacity of the control of corporate structures can result from arrangements involving a company's directors. Corporate directors – one company (or legal person) as the director of another – are inherently opaque with respect to the natural person in fact controlling a company. Where someone controls an appointed director – who might be acting irresponsibly as a 'front' for them – there is also scope for opacity and a lack of accountability. The central problem under consideration is therefore the scope for abuse and mistrust in the current legal framework which provides for opaque arrangements involving a company's directors.

What are the policy objectives and the intended effects?

The policy objective of the *Transparency and Trust* package is to reduce corporate opacity in the UK. By tackling opaque arrangements involving company directors the government is seeking to reduce the potential for abuse of the company structure (for purposes such as laundering money). It is also seeking 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)

0) Firstly we consider the 'do nothing' option and conclude it would not meet the policy objectives. We did consider the scope for alternatives to regulation, but these did not meet the policy objectives. We also rejected acting on different parts of the problem in isolation (for instance considering only certain causes of opacity), but for a comprehensive approach we need to reduce the use of corporate directors and of directors acting as a front for others' control.

1) The first substantive option involves the complete prohibition of the use of corporate directors for UK companies. It also includes increasing the accountability of those who control company directors. This has higher costs to business than the second option.

2) The second substantive, and preferred, option considers a prohibition of corporate directors (in primary legislation) as the default position, with exceptions (set out in regulations). These exceptions would be determined (and potentially varied) at the discretion of the Secretary of State subject to the approval of Parliament, but illustrative scenarios are provided on the basis of exceptions relating to areas of high transparency, regulation and disclosure, and high current use of corporate directors to derive economic efficiency. As with the first option, the preferred option also includes a change to increase the accountability of those who control company directors.

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: Jenny Willott **Date:** 22 June 2014

Summary: Analysis & Evidence — Policy Option 5

Description: Complete prohibition of corporate directors and measures to increase accountability of those who control directors

FULL ECONOMIC ASSESSMENT

Price Base Year 2013	PV Base Year 2015	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -367.87	**High:** -31.45	**Best Estimate:** -46.53

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	36.4		0	36.4
High	330.6		0	330.6
Best Estimate	51.5		0	51.5

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 (£4m); the replacement of a corporate director, should the company decide to pursue that course (£25m); and any resulting reputational damage/disruption (£9m). There would also be costs to government to publicise and implement the relevant regulatory changes (£51,500). Increased accountability of those who control appointed directors might result in familiarisation costs to business of £11m in addition to £2m in one-off disruption costs.

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

N/A

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant	**Total Benefit** (Present Value)
Low	**0**		**0.6**	**4.9**
High	**0**		**0.6**	**4.9**
Best Estimate	**0**		**0.6**	**4.9**

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

We apply break-even style analysis to the familiarisation costs for the policy change to increase the accountability of those who control appointed directors relating to reduced costs to the Criminal Justice System arising from a deterrent effect. Once the change is made, a reduction of 11 court cases related to director disqualification per year will outweigh around 40% of the total familiarisation costs and disruption costs.

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

The benefits derived from measures to tackle opaque company director arrangements will accrue to the government, business and individuals from a reduction in crime. Law enforcement agencies will derive benefits from simpler investigations; the public will benefit from lower levels of crime; and business as well as the public will 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 will also be derived from improved trust and a more transparent environment which facilitates transactions and supports economic growth. We envisage creditors might also benefit since directors being controlled by another will be less likely to cause harm to companies and therefore creditors.

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, on the basis of a follow-up company survey.

BUSINESS ASSESSMENT (Option 5)

Direct impact on business (Equivalent Annual) £m:			**In scope of OITO?**	**Measure qualifies as**
Costs: 4.6	**Benefits:** 0	**Net:** -4.6	NO	**N/A**

Summary: Analysis & Evidence — Policy Option 6 – **preferred**

Description: Prohibition of corporate directors with specified exceptions and measures to increase the accountability of those who control directors

FULL ECONOMIC ASSESSMENT

Price Base	PV Base	Time Period	Net Benefit (Present Value (PV)) (£m)		
Year 2013	**Year** 2015	**Years** 10	**Low:**- 311.90	**High:** -30.43	**Best:** -42.08

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	35.4		0	35.4
High	316.8		0	316.8
Best Estimate	50.0		0	50.0

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

Companies which currently use corporate directors and are not eligible from an exception from a future prohibition would incur costs based on familiarisation with the policy change (£4m); the replacement of a corporate director, should the company decide to pursue that course (£24m); and any resulting reputational damage/disruption (£9m). These costs will occur to a lesser extent for those companies within the scope of exceptions, 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). Increased accountability of those who control appointed directors might result in familiarisation costs to business of £11m in addition to £2m in one-off disruption costs.

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

N/A

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low	0		0.6	4.9
High	0		0.6	4.9
Best Estimate	0		0.6	4.9

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

We apply break-even style analysis to the familiarisation costs for the policy change to increase the accountability of those who control appointed directors relating to reduced costs to the Criminal Justice System arising from a deterrent effect. Once the change is made, a reduction of 11 court cases related to director disqualification per year will outweigh around 40% of the total familiarisation costs and disruption costs.

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

The benefits derived from a reduction of arrangements involving a company's directors which obscure control (including prohibition of corporate directors with a more restricted number of companies in scope), will accrue to the government, business and individuals from a reduction in crime, as per option 1. 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 1. We envisage creditors might also benefit since we might deter poor behaviour from directors and those who control them (which would otherwise have had a negative impact on creditors).

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 on the basis of a follow-up company survey.

BUSINESS ASSESSMENT (Option 6)

Direct impact on business (Equivalent Annual) £m:			**In scope of OITO?**	**Measure qualifies as**
Costs: 4.5	**Benefits:** 0	**Net:** -4.5	No	**NA**

Transparency and Trust – Opaque arrangements involving company directors

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 commitments in relation to opacity around company directors.
- Corporate opacity can facilitate illicit activity and 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 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).
- The use of irresponsible 'front' directors who allow themselves to be controlled by another can similarly introduce opacity with respect to that control and lead to reduced effectiveness of corporate oversight.
- Since all appointed directors have the same status under the law, there is no means of identifying how many appointed directors are acting irresponsibly as a front for another, nor how many people are seeking to control them. But we do know that international organisations and UK law enforcement consider such arrangements high risk in terms of facilitating crime such as money laundering.
- 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 and the practice of directors being controlled by another without accountability.

Policy Objectives and Options

- The overarching policy objectives of 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 opaque company director arrangements. 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 and directors acting as a front for others' control, 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, whilst simultaneously minimising any effects on legitimate business resulting from the policy change.
- The options considered to achieve this objective included:

    - **Option 0:** 'do nothing.' This does not meet the stated policy objectives.
      We also considered the **voluntary** provision of information in relation to individuals within corporate directors, as an alternative to regulation. This does not meet the policy

objectives since those using corporate opacity to facilitate illicit activity would be impervious. This approach was also complicated by the fact that the current regime is set out in statute and changing it requires legislation.
   - **Option 1:** A complete prohibition of corporate directors and new legal means of holding accountable those who control company directors.
   - **Option 2 (preferred):** A prohibition of corporate directors in primary legislation with exceptions from the prohibition set out in regulations. These exceptions could apply to those companies which are subject to wider transparency requirements or regulation, and those which commonly benefit from the appropriate use of corporate directors. We also propose, as per option one, new legal means of holding accountable those who control company directors.[1]

Costs and benefits

- **Option 1:** 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 results in a range of costs to business to comply with the new requirement, largely restricted to those companies which currently have corporate directors. These costs total £51m, which consists of approximately £4m in familiarisation costs for corporate directors; approximately £11m in familiarisation costs related to the policy change to increase the accountability of those who control an appointed director; approximately £25m costs incurred by companies in removing and replacing prohibited corporate directors; around £9m in reputational damage and disruption for the companies removing a corporate director as well as for those acting as a corporate director; around £2m in disruption for companies who might have engagement with people who control directors; and £51,500 in costs to government enacting the changes. We conducted break-even style analysis for the policy change to increase the accountability of those who control an appointed director based on the benefits from reduced court costs arising from a deterrent effect. The benefits totalled around £5m over ten years and outweighed around 40% of the total familiarisation costs and disruption costs. This gives an EANCB of £4.61m.
- **Option 2 (preferred):** 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 £50m, which consists of approximately £4m in familiarisation costs for corporate directors; approximately £11m in familiarisation costs related to the policy change to increase the accountability of those who control an appointed director; approximately £24m costs arising due to companies removing and replacing prohibited corporate directors; around £9m in reputational damage and disruption for the companies removing a corporate director as well as for those acting as a corporate director; around £2m in disruption for companies who might have engagement with people who control directors; and £51,500 in costs to government enacting the changes. The costs and benefits of the proposal to increase the accountability of those who control an appointed director are the same across options one and two. This gives an EANCB of £4.48m.
- The costs and benefits described in this Impact Assessment (IA) are based on the most robust and up to date analysis available.

Implementation

- Primary legislation is being taken forward to implement this policy, supported where necessary by secondary legislation.

[1] Both options will also include, in practice, steps taken on appointment to increase directors' awareness of their duties. These measures are covered in the Impact Assessment which covers the appointment of directors as part of the *Company Filing Requirements* reforms.

A Background

A lack of corporate transparency

1. This Impact Assessment (IA) considers the costs and benefits of action to address the opaque arrangements involving company directors in line with the UK's G8 commitments made in June 2013[2]. Other IAs in this package cover other proposed actions to improve the transparency of ownership and control of UK companies; taken together, the package of measures should meet the G8 objectives to tackle the misuse of companies.

2. The "G8 Action Plan Principles to prevent the misuse of companies and legal arrangements" set out the G8 endorsement of the tenet that companies should know who owns and controls them (Principle 1). Principle 5 sets out that "*the misuse of financial instruments and of certain shareholding structures which may obstruct transparency, such as […] nominee […] directors, should be prevented*." The UK's own Action Plan, which sets out the UK's commitments at the G8, explains at point 7 that we will "*review corporate transparency, including […] nominee directors*." On the basis of the G8 commitments, we propose to restrict the use of corporate directors and implement measures in relation to opaque arrangements involving individual directors – these measures are the subject of this IA. They are required to deliver Principle 5 and support the full implementation of Principle 1 of the G8 Action Plan Principles action plan and to deliver point 7 of the UK Action Plan.

3. The wider G8 communique text captures 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.

B Problem Under Consideration

Corporate transparency – reducing potential for illicit activity

4. Estimates vary as to how much criminal money is generated and laundered within and through the UK. A 2012 EU-sponsored study estimated that about €25bn a year is laundered from UK crime[3]. The Home Office judges that in 2010/11, UK organised crime generated about £13 billion, of which they judge about £10.5bn is laundered. This figure excludes 85% of fraud and other non-organised crime[4]. Furthermore, the social and economic costs of organised crime in the UK are estimated to be £24bn[5], of which £8.9bn are associated with fraud.

5. Internationally, the European Commission's 2013 Impact Assessment of 'Anti-Money Laundering and Terrorist Financing'[6] points to United Nations[7] 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[8].

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2 UK action plan to prevent misuse of companies and legal arrangements (June 2013): https://www.gov.uk/government/publications/uk-action-plan-to-prevent-misuse-of-companies-and-legal-arrangements
3 Project 'ECOLEF', the Economic and Legal Effectiveness of Anti-Money Laundering and Combating Terrorist Financing Policy (November 2012)
4 Home Office (2013) *Understanding organised crimes: estimating the scale and the social and economic costs*
5 Home Office (October 2013) *Serious and Organised Crime Strategy.* This estimate does not include money laundering
6 European Commission (2013) *Impact Assessment : proposal on the prevention of the use of the financial system for the purpose of money laundering, Including terrorist financing* (for revisions of the third money laundering directive)
7 UNODC (October 2011) *Estimating illicit financial flows resulting from drug trafficking and other transnational organized crimes: Research report*.
8 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.

6. Illicit financial flows reflect and result in significant global challenges; illicit flows out of low income countries, particularly in Africa, are sizeable, and often claimed to be more than the aid the developed word provides. Though almost by definition figures are difficult to derive, the Africa Progress Panel chaired by Kofi Annan[9] 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[10].

7. Moreover, as the Government's Serious Organised Crime Strategy[11] 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.

8. 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)[12] has observed that "almost every economic crime involves the misuse of corporate vehicles [ie companies]." A World Bank review[13] reported that 150 of the 213 grand corruption cases investigated involved the use of at least one corporate vehicle to hide beneficial ownership and the true source of funds; the World Bank has confirmed that 26 of these cases involved UK corporate vehicles. In these 150 cases, the total proceeds of corruption were approximately $56.4bn. Meanwhile, the World Economic Forum (WEF)[14] 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.

9. 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 G7[15], 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.

10. UK law enforcement and tax authorities have provided case studies which give an indication of the scope and scale of the misuse of companies. 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. The Serious Fraud Office (SFO) and Metropolitan Police Service (the 'Met') have highlighted a number of cases in which UK and/or overseas-incorporated companies are used to channel illicit funds through the UK; hold UK assets such as property; or perpetuate fraud involving UK citizens. Amounts up to £50m can be involved in such crimes. Recovering the proceeds can be incredibly difficult - if not impossible - not least because of the multi-jurisdictional nature of the various companies involved in the ownership chains.

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9 Africa Progress Panel (2013) *Africa Progress Report 2013: Equity in Extractives*
10 Global Financial Integrity and the African Development Bank (2013) *'Illicit Financial Flows from Africa: Hidden Resources for Development'* (2013)
11 Home Office (2013) *Serious Organised Crime Strategy* (the £24bn cost excludes money laundering)
12 OECD (2011) *Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes*
13 World Bank Publications (2011) *The Puppet Masters: How the Corrupt Use Legal Structures to Hide Stolen Assets and What to do About It.*
14 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."*)
15 Prior to 2014, the G8, including Russia.

11. Companies are used in Missing Trader Intra Community (MTIC) VAT fraud[16] - HMRC's 2011/12 estimate of the MTIC element of the VAT tax gap is between £0.5 and £1 billion. MTIC fraud may be run by Organised Criminal Groups, many of whom have links to other serious crime, and further criminality may be involved through money laundering of the proceeds of the fraud. The City of London Police has indicated that much of the corporate crime they investigate – such as boiler room fraud and scams[17] – involve UK companies. The Financial Services Authority (now Financial Conduct Authority (FCA)) note that victims lose an average of £20k to these scams, with as much as £200m being lost in the UK each year.

12. To take a single striking example, 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[18].

13. The authorities have made a strong case for action to increase corporate transparency. The SFO, the National Crime Agency (NCA), the Crown Prosecution Service, the Attorney General's Office, HMRC and the City of London Police and the Met have been engaged in the development of the *Transparency and Trust* package. They 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[19].

14. The SFO have reported that corporate directors probably feature in around a quarter of their cases, and opaque director arrangements with controlled individuals acting as a 'front' in around three quarters, with the need for action reinforced by further substantiations from the NCA, HMRC and the police. In practical terms, the use of opaque director arrangements stymies their investigations, simply making it more expensive and less likely that they will be able to identify natural persons in whom they are interested.

<u>Corporate opacity and corporate governance</u>

15. *"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.

16. The directors of a company play a crucial role. They are a company's officers, and their details are on the public record at Companies House. Where the director of a company is not functioning effectively in their role, there may be reduced scope for effective corporate governance and valuable oversight and management of the company. We are therefore seeking to determine an effective means of maximising the transparency and accountability of company directors, and confidence in the UK system around company directors, to support effective functioning of companies.

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16 MTIC VAT fraud is an organised criminal attack on the EU VAT system in which fraudulent traders acquire goods VAT free from EU Member States; charge VAT on their onward sale and go "missing" to avoid paying the VAT charged to the relevant tax authorities.
17 Boiler room frauds involve the cold-calling of investors offering them worthless, overpriced or even non-existent shares, promising high returns. See the Financial Conduct Authority website, March 2013:
http://www.fsa.gov.uk/consumerinformation/scamsandswindles/investment_scams/boiler_room
18 http://www.northyorkshire.police.uk/11613
19 Including evidence provided by SOCA prior to the launch of the National Crime Agency in October 2013.

Current UK legal regime around directors

17. A fuller discussion of these issues is provided in Annex D.

18. It is worth briefly considering terminology with respect to company directors, and the opaque arrangements which can sometimes surround them. In the G8 documents and *Transparency and Trust* discussion paper the focus was on corporate directors and so-called ‘nominee’ directors. In the government response to views received on that discussion paper, government’s intentions were set out in more developed terms.

19. A corporate director is a well-established legal concept, referring to one company (or legal person) appointed as the director of another. A nominee director is not a legal term, nor indeed a universally understood or agreed one. In this IA we sometimes refer to and describe the behaviours of those appointed directors who act irresponsibly, as a front for others. A shadow director is currently defined in statute, and refers to a person who controls all or the majority of a company’s directors.

Corporate Directors

20. Currently, as set out in the Companies Act 2006, UK companies can have corporate directors as long as the requirement for companies to appoint at least one director who is an individual (a ‘natural person’) is met. For Limited Liability Partnerships (LLPs), corporate members can be appointed. There is no corresponding requirement to appoint at least one natural person.

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

22. Around 67,000 companies and LLPs currently have corporate directors on their board (or corporate members in the context of LLPs[20]). This represents around 2.1% of all active and dormant UK companies. About 76,000 companies act as a corporate director, and there are around 100,200 corporate directorships.

Natural Person Directors

23. All appointed directors have the same status under the law. But in practice an individual director can act irresponsibly as a ‘front’ for someone else who controls their functions as a director. In doing so, the director might well breach their duties.

24. Defining and measuring instances of directors being controlled by others is not clear. There are some proxy measures we can consider. For instance, where an individual director is registered at Companies House as having multiple directorships, this may be a ground to suggest that the director is not fully involved in each and has let their name be used on the register while control lies elsewhere. Of course a high number of directorships could arise for a number of reasons, for instance in large group structures, which are not related to illicit activity. (At the same time, illicit activity could be undertaken through a company where one front director conceals control for one individual only).

[20] 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.

25. Nevertheless, to understand the extent of what the current system does allow, it is worth noting that 1,223 directors currently act as the director of more than 50 companies, while 6,150 directors currently act as the directors of more than 20 companies. Assuming the directorships are not linked, and there is at most one such ‘front’ director per company board, this equates to at most 8.6% of all UK companies having such a director.

26. There are some current legal means of defining and holding accountable those who control a company’s directors. These persons and their behaviour may currently be covered by provisions such as those relating to shadow directors or offences in statute and common law such as those which seek to capture persons who encourage or facilitate the commission of an offence (for instance by a director). Being a shadow director is neutral in and of itself; the current definition and legal framework simply means that a shadow director can be responsible, when things go wrong, in some of the ways as an individual director would be.

27. There is no means of identifying how many people might be controlling company directors at the moment in the UK. Due to the nature of court reporting, there is also no means of identifying how many cases have involved shadow directors (nor indeed other scenarios such as dishonest assistance in a breach of duty by a director). The Insolvency Service will sometimes have cause to disqualify shadow directors (though it is a small proportion of their total disqualifications of around 1200 per annum).

28. In the overall context of the UK economy, these estimates clearly represent a subset of companies and better practice is likely prevalent more widely. But they are not insignificant, and there is clearly scope for driving down illicit activity in the UK system. At the same time all companies could benefit from the promotion of good practice and support for the business environment in the UK.

The problem - and a route to a solution

29. The central problem under consideration is therefore addressing the scope for abuse in the current legal framework which provides for opaque arrangements involving a company’s directors. Currently the UK framework allows the appointment of one company (or legal person) as the director of another, and provides insufficient accountability where appointed directors are controlled by someone who themself remains off the record.

30. The aim is to limit the use of opaque director arrangements 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).

31. To support the development of solutions, BIS set out the issues and some key questions in the *Transparency and Trust* discussion paper. Following views received on this paper, the preferred option involves a prohibition of corporate directors with some exceptions. These exceptions would be determined (and potentially varied) at the discretion of the Secretary of State subject to the approval of Parliament, but illustrative scenarios are provided on the basis of exceptions relating to areas of high transparency, regulation and disclosure, and high current use of corporate directors to derive economic efficiency. It also includes increasing the accountability of those who seek to control an individual natural person director.

Summary of the Problem Under Consideration

32. The problem of opaque company ownership structures can therefore be summarised as increasing the potential for criminal activity and risking reduced 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. 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 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.

I. Regulatory failure and the potential facilitation of crime

34. 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.

35. Companies and other corporate entities have separate legal personality, meaning 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. Alongside these advantages, which facilitate entrepreneurship[21], a company is required to put additional information in the public domain (e.g. 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, and opaque arrangements involving company 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. This potential for anonymity means that the individuals who 'stand behind' a company can then use the company as a front, for example to launder the proceeds of crime and to finance organised crime and terrorism[22]. A Home Office rapid evidence review (February 2014) concluded that corporate entities can be used to enable or assist criminality, to launder money or to provide prestige or perceived legitimacy. UK enforcement agencies have provided examples of the types of activity that can be facilitated using opaque corporate structures. These include tax crimes such as MTIC fraud; hiding stolen assets and the proceeds of crime; fraud; and drug and people trafficking.

21 Brougham 2011 *Entrepreneur Wealth and the Value of Limited Liability*
22 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.

37. The anonymity afforded by the corporate structure means 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**.

38. 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[23]. The aim of this policy to address the regulatory failure affecting corporate ownership and transparency of control so as to reduce the opportunity for financial criminal activity and thus reduce these costs to the UK.

39. 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 the individuals owning particular assets or who control a company are, 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.

40. The use of opaque arrangements involving company directors offer means to conceal corporate control. The SFO have reported that corporate directors probably feature in around a quarter of their cases, and opaque director arrangements with controlled individuals acting as a 'front' in around three quarters, with the need for action reinforced by further substantiations from the NCA, HMRC and the police.

41. 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.[24]"

42. 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)[25] 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[26] do not directly identify the mechanism, they highlight that reducing crime is thought to support growth.

II. Imperfect/asymmetric information affecting the operation of the business environment

43. 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

23 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.
24 UNODC (October 2011) *Estimating illicit financial flows resulting from drug trafficking and other transnational organized crimes: Research report.*
25 Goulas and Zervoyianni (2013) '*Economic growth and crime: does uncertainty matter'* Applied Economics Letters, Vol 20, issue 5, pp420-427
26 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.

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.

44. 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[27]."* 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.

45. 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[28] 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)[29] 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[30].

46. 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[31]. 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.

47. 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[32] 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) 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 rational and competitive.

27 Hannigan (2003) *Company Law*
28 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.
29 Easley, D. and O'Hara, M. (2004) *Information and the Cost of Capital* The Journal of Finance, Vol. 59, No 4.
30 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* which 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.
31 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.
32 Gigerenzer, Gerd and Selten (2002). *Bounded Rationality*. Cambridge: MIT Press.

48. Opacity could also drive adverse selection[33]. 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 business 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[34]. On this basis, a lack of transparency and trust can inhibit optimal economic activity.

49. 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[35].

50. 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[36] finds evidence suggesting 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.

51. 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 objective

52. The central problem under consideration is addressing the scope for abuse in the current legal framework which provides for opaque arrangements involving company directors. This includes reducing the use of one company (or other legal person) as the director of another and the control of an appointed director by another person with a lack of accountability for wrongdoing.

53. The aim is to restrict the use of opaque director arrangements 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

33 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.
34 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
35 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.
36 Whiteley, P. (2000). "*Economic Growth and Social Capital*," Political Studies 48, 443-466.

- improve the business environment

so as to facilitate economic growth.

E. Description of options considered

Option 0 – Do nothing / Status quo

54. If no action were taken, the use of opaque director arrangements would continue.

55. Under existing legislation, as set out in the Companies Act 2006, UK companies would be able to appoint one or more companies or other legal persons as corporate directors, as long as they had at least one an individual (natural person) director. They would then continue to register their corporate and natural person directors at Companies House.

56. Companies who use corporate directors would continue to derive any benefits they currently derive from this arrangement and Companies House would not be required to invest in the communication and implementation of changes. Directors would continue to be subject to certain duties, prohibitions and liabilities, but those who control them could continue to avoid such standards and accountability if no action were taken.

57. Crucially, no benefits in relation to crime reduction or improved corporate governance and their potential positive impact on economic growth would be realised.

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

59. Moreover, if action were taken in other countries 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.

Option 1 – Prohibiting the use of corporate directors entirely and increasing the accountability of those who control an appointed director

Complete prohibition of corporate directors

60. 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. This would 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.

Pursuing the people behind the directors

61. Focussing on those in opaque director arrangements who might be 'behind' an appointed director, this option includes bringing into scope of legal accountability those who control a single appointed director for illegitimate ends. It would be possible to disqualify (i.e. to remove from the formation or

management of a company) an individual who has controlled a director and caused his misconduct (for which he himself would be disqualified).

62. This would be supported by improved general communication and awareness-raising with respect to directors' general statutory duties. Firstly, there would be new means, to reach each newly appointed director personally to ensure they are aware of their duties (and that operating under the control of another is likely to be a breach of them). This is part of the reformed process for appointing a director[37]. Secondly, it would include updating the duties that apply to shadow directors, who control all or the majority of a company's directors. This would increase clarity of expected standards, and potentially accountability should things go wrong.

<u>Option 2 – Prohibiting the use of corporate directors save in defined circumstances (preferred)</u>

Prohibition of corporate directors

63. This option would again involve the prohibition of corporate directors as the default position - but would also define where companies could be exempted from the prohibition (and could therefore use corporate directors).

64. The details of the exceptions would be determined by the Secretary of State and approved by Parliament. They could therefore evolve. We have highlighted a central scenario for exceptions and highlighted the costs and benefits related to different categories of exception, such that they could be understood through combination and re-combination in future. Illustrative scenarios are outlined in annex E.

Pursuing the people behind the directors:

65. As set out for option 1.

<u>Potential non-regulatory solutions to the problem under consideration</u>

66. We have considered non-regulatory options to address the problem under consideration. These have not been assessed for the purposes of this IA since they were determined unlikely to meet the policy objectives.

67. There are non-regulatory techniques for crime prevention and reduction, as outlined in the Home Office's Serious and Organised Crime Strategy[38] (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 sanctions to allow prosecution and disrupt criminal activity (for example 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.

68. 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

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[37] Please see separate Impact Assessment relating to the government's reforms of Company Filing Requirements.

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

crime as companies engaged in criminal activity would simply opt to ignore any voluntary campaign.

69. 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.

70. With respect to corporate directors, one 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, with those benefitting from illicit activity simply not providing the information voluntarily. This would also have placed the named individual in an ambiguous situation legally with respect to their duties and liabilities. A further option would have been a campaign to promote the use of natural person directors. However, this was considered likely to be ineffective, and potentially perceived as ambiguous since corporate directors would remain permitted in statue (and so much of the landscape in which companies operate is set out in primary legislation).

71. There are certainly non-regulatory steps we can and should take to support successful implementation of the reforms set out here.

72. As mentioned, the most important of these is to improve the communication of directors' general statutory duties. This could increase general awareness of the duties and therefore standards of director conduct and corporate oversight, while also deterring those who might seek to operate outside the duties.

F. Monetised and non-monetised costs and benefits of each option

73. 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.

Option 1 – Prohibiting the use of corporate directors entirely and increasing the accountability of those who control an appointed director

Benefits

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

74. The proposed policy to reduce the use of opaque arrangements involving company directors will help to prevent crime by deterrence, enhancing corporate transparency and in some instances directly removing a mechanism used to facilitate crime. They should result in a situation where apprehending criminals is both cheaper and easier for law enforcement agencies. Consultation with law enforcement agencies revealed strong support for action across the *Transparency and Trust* package including with respect to opaque arrangements involving company directors, 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.

75. 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 and directors acting as a front in about three quarters. 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 as likely to deliver benefits in terms of combating criminal activity.

76. However, 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.

77. On this basis, we have, as set out below, sought to partially monetise the benefits arising from reduced crime of reducing the use of opaque arrangements involving company directors.

Total Economic Cost of Fraud

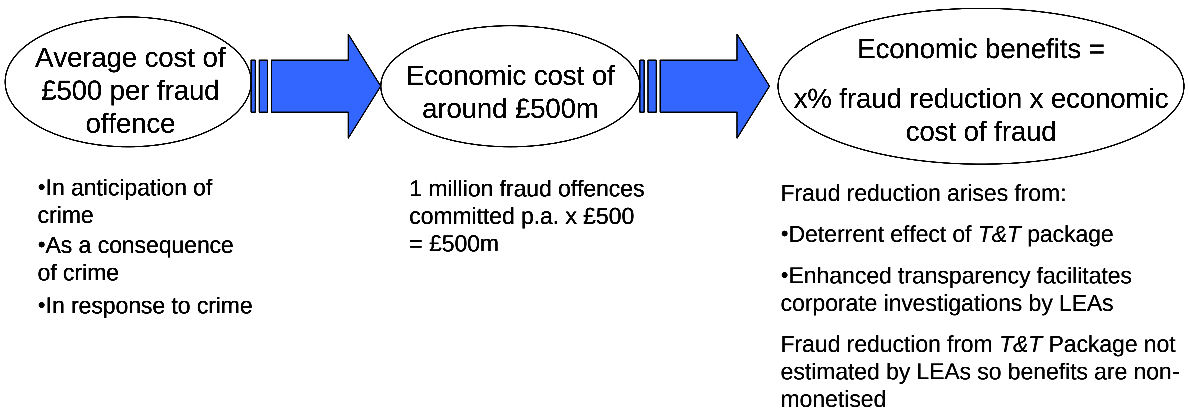

Figure 1: The logic chain behind the benefits of the Transparency and Trust package

78. The crime that can be associated with corporate opacity achieved through arrangements concerning directors is likely to impose significant direct costs on society. These costs include the physical, financial and emotional damage to the victim[39]; insurance expenditure; lost output; and costs to the criminal justice system, including the police.

79. The economic cost of crime for a full range of offence categories has been estimated by Brand and Price (2000)[40]. 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 director arrangements 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.

39 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.

40 Brand and Price (2000) *The economic and social costs of crime* 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.

80. The methodology places a value on the opportunity cost of resources used:

- in anticipation of crime (e.g. insurance[41] 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[42]).

81. 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.

82. We have uprated the average cost estimates for inflation to arrive at estimates in 2013 prices, using standard HMT GDP deflators[43], 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

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

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

83. 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

41 41 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

42 The estimated impact on the Criminal Justice System (CJS) is based on the Home Office 'flow and costs model'. The model estimates the long un 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.

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

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.

84. 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 opaque arrangements involving company director we can estimate, for illustrative purposes, the overall economic cost of fraud, and seek to understand how it might be changed.

85. To arrive at an estimate, we multiplied the average cost of fraud offences by ONS (2013)[44] crime figures. We estimate that there were 1 million fraud offences across the UK in 2012/13[45].

86. On the basis of 1 million fraud offences being committed in 2012/13 with an average cost of ≈£500[46] we estimate that the total economic cost is £523 million, of which £496 million falls on the public sector[47] and £27 million falls on the private sector. This is calculated as follows:

≈£500 x 1million = £523m[48]
Average cost per offence x number of offences

<u>The potential impact of this policy intervention</u>

87. One might expect the impact of the *Transparency and Trust* package, including the present measures, 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.

88. In terms of reduced costs for law enforcement agencies, reducing the use of opaque director arrangements in the UK 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. 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.

89. Work with law enforcement agencies and wider consultation on the proposals robustly confirms that reducing the use of opaque director arrangements in UK incorporated companies would benefit the process of investigating cases. As noted previously, there is no reliable or systematic way of attributing a reduction in the use of opaque arrangements involving company directors to any reduction in law enforcement agencies' costs or the consequences for their processes of a

44 Office for National Statistics (ONS; 2013) *Crime in England and Wales, year ending June 2013 – Appendix tables*
45 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). The NERA (2000) crime figures are disaggregated slightly differently to ONS data but we have arrived at a reasonably close match between the two data sources.
46 To note unit costs are rounded for presentation in the text, with original figures used for calculation to give overall estimates.
47 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.
48 To note unit costs are rounded for presentation in the text, with original figures used for calculation to give overall estimates.

reduction in them, and for this reason, the benefits resulting from reduced costs to law enforcement remain non-monetised[49].

90. We should also note that action to reduce the use of opaque arrangements involving 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 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

91. 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 ongoing economic benefits associated with reducing crime per year:

Reduction in crime	Economic benefit
2% reduction in crime	£10.5m (2% of £523m).
5% reduction in crime	£26.1m (5% of £523m).
10% reduction in crime	£52.3m(10% of £523m).

Table 2: Illustration of ongoing economic benefits associated with reducing crime per year (using average cost of fraud of ~£500)

92. 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 benefit of reducing corporate opacity to reduce this crime would similarly be derived from the reduction in these indicative costs.

Reduction in crime	Economic benefit
2% reduction in crime	£28.5m (2% of £1427m).
5% reduction in crime	£71.4m (5% of £1427m).
10% reduction in crime	£142.7 (10% of £1427m).

Table 3: Illustration of ongoing economic benefits associated with reducing crime per year (using average cost of fraud of ~£500)

93. 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[50]. The Home Office analysis excludes money laundering, which as mentioned above has a significant UK and global impact.

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49 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).
50 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 .

94. 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 opaque arrangements involving company directors, will therefore realise benefits to national well-being, as measured by the National Well-being programme led by ONS[51].

95. 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 ***C. Rationale for intervention,*** Goulas and Zervoyianni [52] found that in times of macroeconomic uncertainty, an increase in crime rate is association with a reduction in annual GDP per capita.

<u>Benefits to the Criminal Justice System from bringing into scope of legal accountability those who control a director</u>

96. As we have set out above, we anticipate some benefits for law enforcement agencies arising from a deterrent effect and a general change in behaviour. Similarly, there could be benefits to the Criminal Justice System (CJS) from a deterrent effect/change in behaviour arising from the policy change to increase the accountability of those who control a single company director, including bringing into scope of legal accountability those who control a single company director. Chiefly, these would arise from fewer cases going through the CJS related to disqualification after the reforms elicit a behaviour change.

97. That is to say, putative 'controllers of directors' (and indeed putative 'controlled directors') will develop a better understanding of what could constitute misconduct and be deterred from it. This could not only help to improve standards of company stewardship but also reduce costs for the CJS if fewer disqualification cases are brought to court. As per standard IA methodology, this is on the basis of 100% compliance with the new policy[53].

98. We view this benefit as separate to the economic benefits of reduced crime detailed above because this relates to the benefits from reduced instances of proceedings against those who control directors, rather than their association with illicit activity such as fraud and the costs that incurs. Below we exclusively estimate the benefits from fewer director disqualification cases so there is no double counting with the section relating to a reduction in financial crime.

99. Although we cannot make any definitive estimate as to how many cases will no longer be brought to court, we are able to offer indicative estimates. In the separate IA covering changes to the director disqualification regime including updates to Schedule 1 of the Company Directors Disqualification Act 1986 (CDDA) which forms part of the present package of reform, the estimate used for the average legal cost per case for a court order was £71,690 and the average legal cost per case for a post-issue undertaking was £20,794. When a director disqualification case went to court it was also estimated to cost the Insolvency Service £35,295 in investigation costs.

100. Over recent years, data from the Insolvency Service show that on average 1,200 company directors are disqualified annually, which represents a little over 0.02% of all 5.7m company

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51 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.
52 Goulas and Zervoyianni (2013) *Economic growth and crime: does uncertainty matter* Applied Economics Letters, Vol 20, issue 5, pp420-427
53 We have no evidence to suggest there would be an alternative level of compliance so we apply this standard assumption here. Naturally, with a lower level of compliance, the benefits will fall (but we cannot estimate the true level of compliance with any certainty). Moreover, if compliance were not 100% there could be costs to the justice system of delivering the accountability – that is to say increased cases which involve those who control a company director.

directors. Of the 1,200 director disqualifications there were 312 post-issue undertakings (i.e. disqualifications occurring after a court order is issued but before the trial has concluded) and 168 court orders. The total cost of both post-issue undertakings and court orders was £24.5m, as shown in the table below. The remaining 720 disqualifications are pre-issue undertakings (i.e. unchallenged disqualifications occurring before legal proceedings have commenced), which have zero cost to the CJS and are therefore not of relevance to this estimate of the benefits.

101. The formula used to calculate the total cost is as follows:

Number of disqualifications x Total cost to the Insolvency Service per case = Total cost

Estimate	Total director disqualifications	Cost per case	Total cost
Post-issue undertaking	312 (65% of 480)	£20,749[54]	£6.5m
Court order	168 (35% of 480)	£106,985	£18.0m
Totals:	480	-	£24.5m

Table 4: Total cost of director disqualifications for the CJS

102. In order to identify the benefits arising from the disqualification cases we expect to be deterred, below we multiply the cost per case by the number of disqualification cases which occurred last year of the most relevant type: Insolvency Service data show that there were 22 disqualifications related to shadow directors[55] over the last two years, so we apply an average of 11 cases per year to estimate the benefits. Here we assume there will be no change in the number of disqualification cases or the characteristics of those cases. Moreover, we assume 100% compliance so anyone controlling a director who falls into scope of the new ground for disqualification will not behave irresponsibly. As a result, any such directors will not be involved in court cases and will count towards the total benefits due to reduced cost to the CJS.

103. The total number of 11 cases can be divided proportionally into post-issue undertakings (65% of cases) and court orders (35% of cases). Given the policy is appraised over 10 years we assume that 7 post-issue undertakings and 4 court orders are averted per year. Though we cannot be certain of the behavioural response, this nevertheless gives an impression of the likely benefits.

104. We think it is reasonable that deterrence in this order of magnitude could be achieved because 11 cases represents only around 2% of all 480 relevant disqualification cases per year.

105. Moreover, the 11 cases we refer to here are of the most relevant type to compare to the present reforms. As previously explained, a shadow director will control the whole (or majority) or directors on a company's board, while the proposed reforms will include those who control a single director and cause their misconduct. Therefore, deterrence of 11 cases of control of a single director per annum seems realistic. In fact, since there could be more people in scope of potential accountability, we can conceive that the deterrent effect would extend to a greater number – perhaps even several times over, and including some cases which result in disqualifications at present under other criteria.

54 Unit costs are rounded for presentation in the text, original values used for calculation of overall effects.
55 The Insolvency Service identified 22 cases involving shadow and de facto directors in the two most recent years of recording. They do not differentiate shadow and de facto director cases, and in disqualification cases the definition of a shadow director (or a de facto director) is not required to be proven in the same way as it is in other sorts of action.

106. And as a final note on this point, updating and clarifying the duties that apply to shadow directors could also drive behaviour change and deter misconduct.

107. On this basis, a rise in the number of disqualified cases (last year) to deterred cases (under the new system) above and beyond 11 cases seems plausible.

108. However, as with all legal changes it is a challenge to accurately predict the resulting impact on the CJS. Although we think it possible that the number of cases averted could exceed 11 per year, we only apply the more conservative 11 cases assumption in our estimate of the benefits.

109. Nonetheless, because we think this to be a restricted estimate of the benefits since the number of people in scope will increase, we include further consideration for illustrative purposes. On the basis of the standard Green Book 100% compliance assumption, the new policy with greater scope will give rise to additional benefits. To give an indication, the policy would have to avert 30 cases per year to break-even against the costs of familiarisation and disruption related to the policy change to increase the accountability of those who control a company director (£13m). (This illustration does not feed into the summary sheet calculations).

110. Our estimate of the annual benefits to the CJS, is as follows:

(7 x £20,749) + (4 x £106,985) = £0.6m
(Number of post-issue undertakings averted x Post-issue undertakings cost per case) + (Number of court orders averted x Court order cost per case) = Total benefit

111. This gives a total benefit of £4.9m in present value terms over 10 years. Moreover, the benefits to the CJS will cover nearly two fifths (38%) of the familiarisation and disruption costs.

112. Of course, as the next section sets out, there are potentially benefits specific to this policy intervention other than those described here with reference to the CJS. We consider additional non-monetised benefits for creditors and for the business environment below.

Benefits to creditors

113. Again based on deterrence and behaviour change, we expect there to be some benefit arising from the improved conduct of directors and those who seek to control them. The strong message sent by the reforms could lead directors to behave more responsibly causing fewer company failures.

114. A potential impact of making it possible to disqualify those who control a single director and cause his misconduct, and of clarifying the duties that apply to shadow directors who control a company's board of directors, could be creditors could having access to funds they otherwise might have lost had the company failed. This type of benefit is a transfer, so remains non-monetised.

115. Firstly, we could anticipate that a well-publicised increase in accountability of those who control directors could improve corporate standards – increasing understanding and reducing instances of poor behaviour or corporate oversight which might otherwise have caused damage to shareholders. Secondly, where we remove a director from the market or facilitate action against someone who controls a director who is damaging a company and affecting its value to shareholders, government can deliver direct benefits. Thirdly, removing an unfit director or a

person who controls them would also protect *future* creditors (and indeed customers) from director misconduct.

116. A further benefit could arise if creditors become less risk averse in the new context; the cost of company finance could fall and access to corporate finance could improve. This would facilitate corporate expansion and more broadly economic growth. (Further non-monetised benefits are described in section B2.)

117. We adopt a similar approach to that used above (where we estimated the benefits from reducing legal costs to the CJS) to provide illustrative estimates of the benefits to creditors from this policy change. As noted above, the scale of the overall benefit from removing those who control a single director cannot be fully monetised. One potential approach to quantification was to build on analysis of current shadow directors - those who control all or a majority of the directors on a company's board - and use that as a starting point to understand how many people might control an individual company director. However, the number of shadow directors cannot be known (and the number of those meeting the definition of a shadow director <u>and</u> being responsible for any misconduct with a cost cannot be known).

118. Companies do not provide details of shadow directors to Companies House. Before 2006 details of shadow directors were provided alongside those of appointed directors. However, the information was not stored in such a way that information relating to shadow directors could be differentiated from appointed directors, so there is not even any historic data. Even if there were it might not have been robust or complete; the definition of a shadow director for operational purposes is normally determined by the court post hoc, alongside consideration of any wrongdoing, and there is no reason to consider that declarations made by the company would have been complete or accurate (which is one of the reasons, we understand, for the change in 2006). The Insolvency Service will deal with enforcement of directors and shadow directors' misconduct, but do not record details relating to numbers of shadow directors in the UK.

119. Given this situation, we therefore adopt a similar approach to that used above to provide illustrative estimates of the benefits to creditors from this policy change. The number of company failures per year caused by those controlling directors under the counterfactual is the total number of court cases averted, as detailed in table 3.

120. As part of the present package of reform changes are being made to update Schedule 1 of the CDDA 1986. In the associated IA relating to changes to the director disqualification regime, the Insolvency Service apply their own 2012-13 data to a 1999 study by the NAO, which quantifies the benefits of disqualifying unfit directors[56]. The key findings are:

(i) failed companies which had one or more directors disqualified had on average £1.5m in debt
(ii) if unfit directors are not disqualified, they have a 7% chance of being associated with a subsequent company failure

Interestingly, several of the Insolvency Service cases involving the disqualification of shadow directors relate to directors who have previously been disqualified as appointed directors returning to exert influence[57]. This suggests the present policy of increasing the accountability of those acting to control a director could be an important step in securing the benefits derived from disqualifying miscreant directors in the first place.

56 http://www.official-documents.gov.uk/document/hc9899/hc04/0424/0424.pdf . These unfit directors also consisted of shadow directors.
57 An example of a recent Insolvency Service case relating to a disqualified director returning to act as a shadow (and therefore facing a further disqualification). http://insolvency.presscentre.com/Press-Releases/10-more-years-for-shadow-director-s-breach-of-disqualification-order-689c8.aspx

121. To arrive at an estimate of the benefits to creditors, we apply the following formula with the associated sensitivity analysis outlined in the table. This gives us a best estimate of £2.6m per year and an undiscounted total of £26m over the ten year appraisal period. However, this is an estimate of the benefits to creditors and because it is a transfer it remains non-monetised in the summary sheets for this IA.

25 x £1.5m x 7% x 10 = £26m

Number of company failures caused by shadow directors p.a. x Average deficiency x Percentage of further company failures prevented x 10 years

Estimate	Company failures involving misconduct of shadow directors	Average deficiency	% company failures prevented	Time horizon	Total benefits
High	34	£1.5m[58]	7%	10 years	£36m
Best	25	£1.5m	7%	10 years	£26m
Low	17	£1.5m	7%	10 years	£18m

Table 6: Benefits for creditors from increasing the accountability of individuals controlling a company director

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

122. Option one would deliver benefits for the business environment resulting from greater transparency around company control relating to a reduced use of opaque arrangements involving company directors.

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

124. 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[59]. Therefore increased corporate transparency can increase economic growth through the mechanism of increasing trust and reducing transaction costs. A more detailed explanation of the theoretical and empirical framework linking trust, transparency and growth is set out in Annex F

125. To consider this issue in more detail with respect to the present policy change, we can consider that if trust in the quality of UK directorships is high this would support confidence in the business environment. Determining who can be a director (a company or a natural person) is part of this trust, but enforcement of directors' conduct is also central. An improved understanding of directors' duties, the grounds for disqualification and increasing the legal accountability if those who control a

58 Unit costs are rounded for presentation in the text, original values used for calculation of overall effects.
59 The importance of trust in economic transactions is highlighted in Fukuyama, F. (1996) '*Trust the social virtues and the creation of property*'

company director could help improve perceptions of the regime. Shareholders and creditors might therefore be confident that their rights will be protected.

126. Moreover, if external sources of control over an appointed company director are deterred, there could be benefits to company decision making. For instance, behaving in self-interested manner, a controlling person might influence decisions that benefit themselves more than the company, or potentially disadvantage the company. By discouraging this type of behaviour, the reforms will remove a distortion to company decision making, which is potentially economically damaging. Where there is opaque control, and this is known to be possible in the business environment, this could feed into greater transaction costs and reduced trust. The benefits would come from countering this.

127. By increasing corporate transparency, including through the creation of a central registry of company beneficial ownership information (or people of significant control), benefits to trust, and therefore the business environment and potentially economic growth, should be realised.

Costs

128. 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 support criminal purposes). Increasing the accountability of those controlling an individual appointed company director would be more limited in its impact, since it would not require companies to become compliant with a new requirement.

129. The costs related to 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

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

130. The cost estimates below are based on a range of evidence drawing in large part on a survey of companies undertaken by IFF Research (2013; see Annex A). The costs identified through the survey have been processed - using statistical adjustments and in the light of subsequent discussions/interviews with companies - 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 implausible high values that could make the dataset less robust and the re-coding of zero wage cost values based on the results of our focus groups and follow-up survey (again, see Annex A).

131. For the basis of the calculations related to corporate directors 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[60]), 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.

60 Of which around 29,000 are LLPs

a) Public Sector Communication and Implementation Costs

C1) Public Sector Communication and Implementation Costs

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

133. 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[61] 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.

134. 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 the *Transparency and Trust* measures covering the register of company beneficial ownership (people with significant control) and directors[62], the costs for communicating each policy measure would be around £11,500 (£23,000 ÷ 2). In fact, communication costs would likely be split across a wider range of policy areas which would reduce the costs per policy further.

135. In terms of development and implementation costs, Companies House will need to update its systems. 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; our best estimate of costs for Companies House will total £51,500 (£11,500 + £40,000). Companies House have noted that, based on the current level of information, they do not anticipate the need to charge higher fees to companies as a result of this proposal[63].

136. This IA assumes 100% compliance in accordance with standard practice, thus costs to the public sector in the context of the courts system would theoretically be zero[64]. 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. We would also anticipate a deterrent effect, which would be enhanced by non-regulatory means of communicating directors' duties to those appointed directors who might be

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

62 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,

63 We expect there to be transition costs to software providers associated with updating their standard packages to reflect the changes in the Transparency and Trust and Company Filing proposals. Software companies provided a single cost estimate for the policy proposals collectively rather than broken down by proposal. Discussion of these cross-cutting costs is included in the Company Filing validation IA. Therefore we have not included the costs here to avoid double counting.

64 We have no evidence to suggest there would be an alternative level of compliance so we apply this standard assumption here. Naturally, with a lower level of compliance, the benefits will fall but we cannot estimate the true level of compliance with any certainty.

acting irresponsibly as a front. A full Justice Impact Test is being developed with the Ministry of Justice.

137. We plan to use offences where necessary to underpin the new regime, but we do not expect prosecutions to be high partly because of the deterrent effect and because, with respect to the changes to the regime around corporate directors, there would be a process of promoting compliance before recourse to a prosecution. With respect to increasing the accountability of those who control a company director, there could be some cost impact on the courts but there would also be a deterrent effect. It is worth noting that currently shadow director cases are reasonably rare; as mentioned, Insolvency Service records indicate there were 22 disqualifications of a shadow director in the last two years.

b) Private Sector Costs

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

138. To identify how a company would behave and what costs might arise following a prohibition of corporate directors, the company 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.

139. 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. The survey found that 50% of all companies would replace a prohibited corporate director with a ‘natural person’[65].

140. Of the companies with a corporate director, 42% would replace them following a prohibtion[66]. 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). 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 assume here that this (quicker and cheaper) process costs the same. As such this will overestimate the cost.

141. Our company survey identified a ‘high’ estimate of around £351 for a company removing and replacing a corporate director. This estimate consists of £125 in internal wage costs and £226 in additional costs (e.g. legal advice). We explain in full how we arrived at these figures in annex A. 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.

142. This gives a total, our ‘high’ cost estimate, of around £35m for this group of companies, which is therefore likely to be an overestimate. This is calculated as follows:

(≈£351 x (50% x 100,200)) + (≈£351 x (50% x 100,200)) = £35m

65 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.
66 The three companies which responded ‘don’t know’ have been distributed across ‘yes’ and ‘no’ as per the above.

(Cost of replacement x (replacement percentage x companies with corporate directors) + (Cost of removal x ((1 - replacement percentage) x companies with corporate directors)

143. However, in the company survey, some respondents struggled to provide a definitive estimate due to the hypothetical nature of the questions, but given how few corporate directors there are we have to accept this data limitation.

144. The original company survey also threw up some particularly high cost estimates but upon revisiting these responses in the follow-up survey, some companies were surprised by their original responses and revised down their estimates considerably:

> *That does seem a lot actually in terms of replacing a corporate director with an ordinary one. On reflection, that feels a little bit high really. Maybe I didn't quite understand the question. I can't possibly think how I got to these figures* *[Large, simple company]*

> *Well thinking about it, if you're just talking about the admin part of it like literally removing and reappointing them. Why it should take that long? It would probably take longer but you would have to change the books and records of the corporate that was resigning as a director. And then you would have to change the books and records of the new corporate. Then the person as well would have to get their own things in order which would be an issue for the current staff. So I think it might actually take longer, but it depends if you're talking about having come to the decision and just going through the process. It might take 2 hours each actually (including a PA)* *[Large, complex company]*

> *Thinking back, it probably would involve some time. Not a lot. One middle manager no more than 2 hours.* *[Large, complex company]*

145. There is scope for overestimation of costs of removal and replacement in terms of any moderation by 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. We previously assumed there would indeed be some cost savings for such companies. However, the RPC queried this so we have now removed this assumption. Our 'high' cost estimate of £35m therefore assumes no such efficiency savings.

146. While we are not able to pursue this assumption or quantify the efficiency savings, it is worth noting there could in principle be some cost saving for companies processing the removal of multiple directors. For this reason, all our estimates for the replacement of a corporate director leave scope for even greater reduction in costs relative to these estimates, and these figures therefore potentially overestimate the cost.

147. In terms of our 'low' estimate, we estimate it costs around £135 to comply with the appropriate process (£58 in wage costs and £77 in additional costs – as shown in Annex A, which describes the methodology behind these costs). This yields a 'low' estimate of around £13m. Using the same calculation for our 'best' estimate, with an estimated mean cost of about £162 per company (£67 wage costs and £95 additional costs) we arrive at a figure of £16m.

Estimate	Number of corporate directorships	Average cost per company	Total cost
High	100,200	£351[67]	£35m
Best	100,200	£162	£16m
Low	100,200	£135	£13m

Table 7: Removal and replacement cost estimates for companies with a corporate director

148. 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 ≈£87 (as a 'best' estimate) would fall on companies acting as corporate directors. This consists of £39 in wage costs and £47 in additional costs. Overall, this equates to £9m as a 'best' estimate. The formula below details how we arrived at our estimates and the table details the 'high', 'low' and 'best' estimates.

≈£87 x 100,200 = £9m
Cost of removal/replacement x number of corporate directorships

Estimate	Number of corporate directorships	Average cost per company	Total cost
High	100,200	£182[68]	£18m
Best	100,200	£87	£9m
Low	100,200	£71	£7m

Table 8: Removal and replacement cost estimates for companies acting as a corporate director

149. 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 (£9m + £16m).

150. For the policy change to increase the accountability of those who control a company director we assume that if the behavioural change caused by the reforms causes a source of control to director to withdraw from that position of influence, they can do this at zero cost. The whole basis of the relationship is informal, so ending that relationship will require no formal process; a person responding to the increased accountability could simply cease communication with the company.

C3) Any resulting disruption reputational damage and loss of benefits after corporate directors are prohibited

151. 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.

152. 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.

67 Unit costs are rounded for presentation in the text, original values used for calculation of overall effects.
68 Unit costs are rounded for presentation in the text, original values used for calculation of overall effects.

153. 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, and 11% answered that they did not know about the advantages.

154. Below we interrogate the data regarding advantages of corporate directors derived 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 direct, first hand views and are expected to be more accurate a reflection of views than those of companies *without* corporate directors who have responded to hypothetical questions.

155. 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. Overall, just under 64% of companies with corporate directors thought there advantages associated with them.

156. 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. Adding the advantages of skills, management continuity and efficiency to the series of other advantages companies thought they would lose if corporate directors were prohibited (listed in table 7), this would total at most 42,800 companies or just over 1% of all UK companies.

157. 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 chosen to appoint one).

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 9: Answers from companies with corporate directors to the survey question: 'what advantages can you see to having a corporate director on the company's board?'

158. 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; 3.6% of companies thought the prohibition of corporate directors would damage their reputation;

and 5.5% thought it would cause some disruption to their business. Applying this to the 67,000 companies with corporate directors, we can therefore estimate that around 2,400 companies would suffer costs resulting from reputational damage and around 3,700 companies would suffer business disruption. This would total at most 6,100 companies or 0.19% of all UK companies.

159. In the consultation IA, the RPC commented that we should monetise the disruption and reputational damage. We therefore do so here. Although the majority of respondents in the company survey did not report any hypothetical reputational damage or disruption, there were a few companies, which emphasised the relevance of this cost. For this reason, we agree it is important to monetise it fully despite the limited evidence associated with it.

> *Well, would there be any cost in us doing that, well of course there would be a loss of fees, a considerable loss of fees.* *[Small, simple company]*

> *I think there might disruption to the business and I still do think that, because I think people will be seeing and speaking to that person and I think there would some explaining. I do think there will be costs …* *[Small, simple company]*

160. Our survey asked companies to estimate the likely cost of disruption or reputational damage, which can also be applied to the lost advantages for companies losing a corporate director from their board. We were therefore able to arrive at a 'best' cost estimate as follows:

≈£193 x (6,100 + 42,800) = £9m
Cost of disruption/reputational damage x (number of companies suffering reputational damage or disruption + number of companies losing advantages)

161. For our 'low' estimate we applied a cost of £95 per company to the same 48,900 companies affected giving a cost of £0.6m. By contrast, for our high estimate, we applied the figure of £290 to all 67,000 companies with corporate directors giving £20m, as shown in the table below.

Estimate	Number of companies affected	Average cost per company	Total cost
High	67,000	£290[69]	£20m
Best	48,900	£193	£9m
Low	48,900	£95	£5m

Table 10: Cost of disruption, reputational damage and lost advantages for companies with corporate directors

162. Surveying companies from the point of view of those acting as corporate directors, 86% 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 a total of 1,500 companies (2% of 76,000).

163. We arrived at a 'best' estimate of the cost for companies which are corporate directors of £0.2m as follows:

≈£135 x 1,500 ≈ £0.2m
Cost of disruption/reputational damage x number of companies suffering reputational damage

69 Unit costs are rounded for presentation in the text, original values used for calculation of overall effects.

164. For our ‘low’ estimate we applied a cost of £10 per company to the same 1,500 companies affected giving a cost of £15,000. By contrast, for our high estimate, we applied the figure of £259 to all 76,000 companies which are corporate directors giving £20m, as shown in the table below. Our best estimate for this section therefore totals £9.2m (£9m + £0.2m).

Estimate	Number of companies affected	Average cost per company	Total cost
High	76,000	£259[70]	£20m
Best	1,500	£135	£205k
Low	1,500	£10	£15k

Table 11: Cost of reputational damage for companies acting as corporate directors

165. We also expect there to be some cost of disruption for the companies where they choose to alter the relationship they have with those who control their directors. Ultimately, a line of communication could cease, which could result in some disruption similar to that described with respect to changes to the regime around corporate directors.

166. An appropriate proxy for the number of people who control a company director can be derived from an estimated number of ‘front’ directors (i.e. registered directors who surrender control to another party). As mentioned earlier, however, it is not possible to identify with any certainty the number of directors acting as a front, since all directors register at Companies House on the same basis. However, one loose indicator of a director acting irresponsibly as a front is the number of directorships held.

167. For instance if more than 20 directorships are held, it is possible - though not by any means certain - that there could be a deficiency in effective corporate governance, and even that the director could be breaching their duties. Of course, multiple directorships might be unrelated to external control of that director, and a director acting only for one company could be controlled by another. But for the purposes of this analysis, we consider these figures relating to multiple directorships a useful starting point in terms of evaluating the possible prevalence of opaque arrangements involving company directors.

168. Companies House data shows that 6,150 directors currently act as the directors of more than 20 companies. Assuming the directorships are not linked, and there is at most one ‘front’ director per company board, this equates to at most 273,000 UK companies having such a director. Companies House data show there are around 3.19m[71] companies on the register and 5.67m directors – suggesting an average of 1.8 directors per company. Applying this more conservative assumption (i.e. 273,000 / 1.8) gives a figure of 154,000 UK companies having such a director, which we use below as a reasonable proxy for the number of putative controllers of directors.

169. Here we apply the costs of disruption which we draw from analysis of the corporate director reforms. We have done this on the basis that we cannot directly survey those who control a director due to their hidden nature. We think given the similarities of the reforms there are reasonable grounds to expect the costs to be comparable for the reforms to increase the accountability of those who control company directors.

70 Unit costs are rounded for presentation in the text, original values used for calculation of overall effects.
71 Company population estimates were extracted from the FAME database (Bureau van Dijk Electronic Publishing, 2013) on 13 December 2013

170. On the basis of there being 154,000 companies with directors who are controlled by another, if 5.5% of them suffer disruption (as per the corporate directors estimate), this would result in 8,400 undergoing some disruption cost. We apply the below formula to arrive at a best estimate of around £2m.

≈£193 x 8,400 = £1.6m
Cost of disruption x number of companies suffering disruption

Estimate	Number of companies affected	Average cost per company	Total cost
High	8,400	£290[72]	£2.4m
Best	8,400	£193	£1.6m
Low	8,400	£95	£0.8m

Table 12: Cost of disruption, reputational damage and lost advantages for companies with directors controlled by another person

C4) Familiarisation with the proposals (staff time and any additional costs)

<u>Corporate Directors</u>

171. 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.

172. The survey identified a 'high' end average familiarisation staff cost per company of ≈£69, which consists of £26 in wage costs (i.e. internal staff time) and £43 in additional costs (e.g. legal advice). 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.

173. Our reasoning for truncating the extreme responses (see Annex A), particularly at the upper end of the distribution, was validated in the second company survey. Firstly, some companies included other compliance costs in their familiarisation cost estimate. Secondly, in the light of new policy information, a number of companies revised down their estimates:

> *It's not as easy as I've read the paper, I understand it, because if you aren't compliant you then have to do something to make yourself compliant. [Large, simple company, which is a corporate director]*
>
> *If it's only 4 pages [of guidance] then I think it would decrease, by easily 50%.I think it's probably just less time-consuming and less difficult to get to grips with… It sounds like there would be less jargon than I thought... [Small, simple company]*

174. We have calculated a 'high' cost estimate, where we assume that all 3.19 million (active and dormant) companies registered in the UK[73] 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 £221m.

72 Unit costs are rounded for presentation in the text, original values used for calculation of overall effects.
73 Company population estimates were extracted from the FAME database (Bureau van Dijk Electronic Publishing, 2013) on 13 December 2013

≈£69 x 3.19m[74] = £221m[75]
Cost of familiarisation x number of companies

175. 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.

176. Our ‘low’ estimate totals £3m and is based on all 143,000 companies (both acting as corporate directors and including those with corporate directors on their board) familiarising themselves with the changes at a cost of ≈£20[76] each (≈£20 x 143,000). In the consultation IA the RPC commented that our ‘low’ estimate should include companies which act as corporate directors so we have updated our calculation accordingly.

177. Our ‘best’ estimate similarly 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 £4m (≈£29 x 143,000, whereby £13 is wage costs and £16 is additional costs).

Estimate	Number of companies	Average cost per company	Total cost
High	3.19m	£69[77]	£221m
Best	143,000	£29	£4m
Low	143,000	£20	£3m

Table 13: Familiarisation cost estimates for corporate directors

<u>Increasing the accountability of those who control company directors</u>

178. There will also be some limited familiarisation cost associated with companies reading and understanding the changes to the accountability of a person who controls a company director.

179. In the second iteration of our company survey, we asked 19 companies questions related to directors. Since some of these questions relate to the role of directors and those who control them, consideration of the responses is informative, and gives us some indication that changes in this space will not be too onerous in terms of familiarisation. Of these respondents, 16 stated they were familiar with the statutory duties of a director. In focus group discussions, participants were often familiar with the current definition of a shadow director, and expected those working as a director to know about the shadow director definition too.

180. The limitations to our assessment of the numbers of current shadow directors and those who might be interested in an increase in accountability of those who control a company director in the UK, set out above, apply equally to any analysis of how many companies might be in scope of familiarisation costs.

74 Company population estimates were extracted from the FAME database (Bureau van Dijk Electronic Publishing, 2013) on 13 December 2013
75 Unit costs are rounded for presentation in the text, original values used for calculation of overall effects.
76 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.
77 Unit costs are rounded for presentation in the text, original values used for calculation of overall effects.

181. Nevertheless, there are reasons to believe only a small number of companies will engage with the change. The small proportion of current disqualification cases relating to shadow directors suggests only a small number of companies will be close to being involved with a shadow director. This could also suggest that there will only be small number of companies involved with those who control a single company director. For the purposes of this section we use, as set out above, the proxy of 154,000 companies (where there might be a controlling influence over a director).

182. Considering evidence relating to the nature of familiarisation, in the survey we asked how long it might take a director to read the statutory duties of directors. The average response from companies was around one and a half hours with a range of between 30 minutes and 4 hours. Given that the proposed changes to the accountability of those controlling a company director will be smaller than the current duties, we think the time taken for familiarisation with the change could be less than one and a half hours. Nonetheless, to arrive at a cost estimate we multiply the estimated time to read the duties by the wage of a director, as a conservative estimate.

183. The total familiarisation cost is estimated as per the formula below. This gives a 'best' estimate of £11m, as detailed in the table in which we apply some sensitivity around our central estimate:

Time to review duties x Wage of a director x Number of directors in scope

Estimate	Time to review duties	Director's median wage[78]	Number of directors in scope	Total cost
High	2 hours	£48.36[79]	154,000	£15m
Best	1.5 hours	£48.36	154,000	£11m
Low	1 hour	£48.36	154,000	£7m

Table 14: Total cost of familiarisation

184. However, those controlling company directors could be private individuals. The opportunity cost of their time could be lower than that of a paid director – reducing the cost. Given the lack of evidence, we have, however, been unable to quantify the split between private individuals and directors. As a result, we have assumed all those who control a company director are the equivalent of a paid director, providing high cost estimates and again rendering our estimates conservative.

185. Nevertheless, to demonstrate the potential reduction in our estimates if individuals were involved in familiarisation rather than directors, we have repeated the calculations using an individual's time. The hourly value of an individual's time, uprated to 2013 prices is £6.20[80], whilst the ASHE median wage per hour (up-rated to 2013 and including non-wage costs) for all employees is £15.40[81]. Using these rates would reduce costs to £1.4m and £3.6m respectively.

Option 2 (preferred option) – Prohibiting the use of corporate directors save in defined circumstances and increasing the accountability of those who control an appointed director

186. As set out above, this option consists of a prohibition of corporate directors with the potential for exceptions. As for option one, it includes changes to increase the accountability of those who control company directors.

78 These estimates are the weighted average of a senior manager's wage for small and large companies, as detailed in Annex A
79 Unit costs are rounded for presentation in the text, original values used for calculation of overall effects.
80 http://www.dft.gov.uk/webtag/documents/expert/pdf/u3_5_6-vot-op-cost-120723.pdf
81 Office of National Statistics (ONS; 2012) *Annual Survey of Hours and Earnings*. Up-rated by 17.8% for non-wage costs.

187. The exceptions from the prohibition of use of a corporate director would be determined (and potentially varied) at the discretion of the Secretary of State subject to the approval of Parliament, but illustrative scenarios are discussed here. Exceptions could usefully apply where we consider there is reduced potential for abuse, for instance where the companies involved are large and subject to stringent regulation 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 exceptions are formalised in regulations, we will undertake further analysis with respect to that step. For the present purposes, we set out the relative costs and benefits of some illustrative scenarios, setting out potential exceptions, which are described in more detail in Annex E. For the purposes of the present IA, we consider a scenario which includes exceptions from the prohibition from corporate directors in the following cases:

- Where the parent company is listed on an EU regulated market
- Where the parent company is a sufficiently large private company in a group structure
- Charitable company
- Pension companies

188. In reviewing the consultation stage IA, the RPC queried how SMEs would be affected and if there would be any exception for them. We do not propose to exempt small companies from the prohibition of corporate directors on the grounds that this will hamper the achievement of our policy objectives, namely the reduction of crime and increased transparency. As detailed in the Small and Micro Business Assessment below, any such exception would create a loophole for those seeking to engage in illicit activity, which would be inconsistent with the aims of the *Transparency and Trust* package. We have also been informed by business representative organisations that they do not anticipate the reforms to corporate directors will have a significant effect on SMEs. Given the wider exceptions, if a company is small and included within them it will not be in scope of the prohibition of corporate directors.

189. The below table details the number of active UK companies under each of the proposed exceptions using estimates from the Fame database[82]. 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 exceptions. For the purposes of this IA, we will work under the assumption that all four exceptions are legislated for. However, the estimated costs and benefits can easily be disaggregated to offer useable estimates for any combination of these exceptions, and the same approach could be applied to any further desired exceptions.

82 FAME database (2013) Bureau Van Dijk Electronic Publishing. Retrieved on 24 October 2013

	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[83]	1,200 with 61,500 subsidiaries	30 / 1,300 including subsidiaries[84]	30/1500 including subsidiaries
Charity[85]	22,100	400	500
Pension funding[86]	1,400	30	30
Private & group structure[87]	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 15: Estimated number of exceptions (rounded to nearest 100 companies)

<u>Benefits</u>

190. The benefits of option 2 (prohibiting corporate directors with specific exceptions), should be broadly the same as those that would be delivered under option 1 (prohibiting corporate directors entirely). As regards the changes related to increasing the accountability of those who control a company director, the same estimates apply under option 1 and option 2 – again our analysis shows the policy could feasibly outweigh around 40% of the costs.

191. The total of all four exceptions from the prohibition of corporate directors 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 increase relative to the usage of corporate directors under option 1. As noted above exceptions will be restricted to sectors which we can change if necessary, but where overall we are confident in wider regulatory and disclosure requirement.

192. Not only would the direct benefits with respect to reducing crime be accrued under option 2 without much reduction relative to option 1, 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 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 1, since the policy change including the default prohibition will send a strong signal in terms of trust in business in the UK.

193. 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.

83 This includes companies listed on an EU regulated market and filling group accounts.
84 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 exceptions.
85 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.
86 This includes companies classified under SIC (2007) code 65.300
87 This is based on companies identified as private and filling group accounts.

Costs

194. In terms of the overall impact, a system of specific exceptions 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

195. 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)

196. 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 by under £500k to £16m for our 'best' estimate. The corresponding 'low' and 'best' estimates are calculated below, adhering to the same cost saving method as in option 1, and their calculation is also explained fully in Annex A.

100,200 - 3,100 = 97,000
Number of companies with corporate directors - exceptions = Number of companies with corporate directorships in scope

100,200 - 3,500 = 96,600
Number of companies acting as corporate directors - exceptions = Number of corporate directors in scope

Estimate	Number of corporate directors in scope	Average cost per company	Total cost
High	97,000	£351[88]	£34m
Best	97,000	£162	£16m
Low	97,000	£135	£13m

Table 16: Removal and replacement cost estimates for companies with a corporate director

197. 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 8) will reduce costs relative to option 1 by just under £1m. This will total £8m as a 'best' estimate.

88 Unit costs are rounded for presentation in the text, original values used for calculation of overall effects.

Estimate	Number of corporate directorships	Average cost per company	Total cost
High	96,600	£182[89]	£18m
Best	96,600	£87	£8m
Low	96,600	£71	£7m

Table 17: Removal and replacement cost estimates for companies acting as a corporate director

198. 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

199. As per option one, we monetise relevant ongoing costs related to the loss of advantages conferred by use of a corporate director. 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 1. 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 exceptions 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.

200. 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. In addition to the number of companies losing other advantages from having a corporate director, the total number of companies affected would be 40,800. Similarly, the ongoing direct costs 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 3,200 (5% of 64,200).

201. Applying the same methodology as under option 1, we arrive at a best estimate of around £6m (around £300k lower than option 1).

Estimate	Number of companies affected	Average cost per company	Total cost
High	64,000	£290[90]	£19m
Best	46,700	£193	£9m
Low	46,700	£95	£4m

Table 18: Cost of disruption, reputational damage and lost advantages for companies with corporate directors

202. From the perspective of costs for the 76,000 companies acting as corporate directors, which is expected to fall to 72,500 including the exceptions, around 1,500 companies (2%) are estimated to suffer a negative impact on their reputation. Again we calculate these costs in the same way as under option 1, giving a 'best' estimated of £196k.

89 Unit costs are rounded for presentation in the text, original values used for calculation of overall effects.
90 Unit costs are rounded for presentation in the text, original values used for calculation of overall effects.

Estimate	Number of companies affected	Average cost per company	Total cost
High	72,500	£260[91]	£19m
Best	1,500	£135	£196k
Low	1,500	£11	£15k

Table 19: Cost of reputational damage for companies acting as corporate directors

203. Our best estimate for the costs of disruption and reputational damage related to corporate directors therefore totals £9.2m (£9m + £0.2m). The cost of disruption from policy change to increase the accountability of those controlling a company director is estimated to be £2m as per option 1.

C4) Familiarisation with the proposals (staff time and any additional costs);

204. As set out in option 1, 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 exceptions, 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 exceptions. Therefore, fewer companies would need to go through all the stages of familiarising themselves with the changes they need to make.

205. As set out above, around 150,000 companies in this illustrative scenario could be in scope of an exception 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 1, 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.

206. 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.

207. 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 exceptions, using a corporate director and therefore needing to go through full familiarisation is likely to be well under 150,000.

208. For our 'best' and 'low' estimates, given in the table below as £4m and £3m respectively, we have assumed a uniform distribution of corporate directors across all 3.19m companies[92], whether they are listed, charity companies, pension companies, private groups or otherwise[93]. 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:

91 Unit costs are rounded for presentation in the text, original values used for calculation of overall effects.
92 Company population estimates were extracted from the FAME database (Bureau van Dijk Electronic Publishing, 2013) on 13 December 2013
93 The register as held by Companies House does not disaggregate corporate director data by SIC to allow us to apply specific figures.

(143,000 – ((150,000 / 3.19m) x 143,000) x ≈£29 = £4m
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 exceptions	Average cost per company	Total cost
High	3.19m	NA	£69[94]	£210m
Best	143,000	135,000	£29	£4m
Low	143,000	135,000	£20	£3m

Table 20: Familiarisation cost estimates

209. The familiarisation costs as they relate to the policy change to increase the accountability of those controlling individual company directors would be as set out in option one, giving a best estimate of **£11m**.

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

210. We believe the analytical approach taken in this IA 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.

211. 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. In the original *Transparency and Trust* discussion paper we set out some preliminary thinking on costs and benefits and sought views on it. This approach was chosen over publication of a consultation stage IA because of the stage of policy development and evidence collection. We have since published a consultation stage IA with an RPC opinion.

212. Then, during the call for views on the discussion paper, which fed into the evidence base underlying the consultation stage IA and this final stage IA, we :

- consulted with the Economic and Social Research Council;
- consulted with Companies House
- undertook 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-one meetings; and
- commissioned a company survey through IFF Research (see Annex A).

213. 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.

214. For the purposes of the Final IA, we built on the existing evidence base with the following:

- an extension to the company survey, consisting of largely qualitative questions
- a series of focus groups consisting of businesses and trade associations

94 Unit costs are rounded for presentation in the text, original values used for calculation of overall effects.

The company survey was used to firstly inform the way we treated the original survey data and secondly to understand what underpinned the cost estimates. To achieve this we held a series of in depth interviews with respondents (the methodology and its implications are explained fully in Annex A). The focus groups were used largely to validate the estimates we produced in the consultation stage IA.

215. Throughout this process, the evidence gathered from stakeholders has played 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.

216. 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 on the business environment.

217. 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.

218. As noted, the evidence we have gathered to inform cost estimates in this IA 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 IA. However, to gain a better grasp of how to treat these data we undertook a follow-up survey, which helped us identify where it was reasonable to truncate the data and it largely validated the estimates and approach we used in the consultation stage IAs (Annex A).

219. We also held a number of business focus groups, which discussed the likely costs of the proposed reforms related to beneficial ownership and opaque arrangements involving company directors. [95] Largely the companies present agreed with our cost estimates, particularly for small companies. However, many companies did comment that compliance could cost considerably more for large and more complex companies if legal and accountancy costs were required. Nonetheless, given that our estimates were weighted by the population, which is 98% small companies, this would bring the estimated costs down so the focus groups broadly validated the figures we presented to them.

220. We are satisfied that the evidence presented here represents the most comprehensive and robust assessment available for a final stage IA within the constraints of proportionality with respect to both cost and time.

[95] Please see Annex B for the attendance list.

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 (iii) Lack of evidence with respect to current and projected numbers of shadow directors as a basis for considering control of an individual director	• 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'[96] • Evidence from the Home Office does not fully disaggregate by type of fraud and only gives a high level aggregate figure. • Even historic or current data relating to shadow directors are not recorded.
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	(i) Lack of evidence with respect to current and projected numbers of shadow directors as a basis for considering control of an individual director	• Even historic or current data relating to shadow directors are not recorded.
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	N/A
Communication, publication and implementation costs for govt.	N/A	N/A

Table 21: Summary of Evidence

96 Financial Action Task Force: "Money Laundering FAQ;" FATF website

H. Risks and assumptions

221. Following standard IA methodology, we have assumed 100% compliance. There is, however, a risk of non-compliance resulting in an impact on the criminal justice system. This is the subject of a Justice Impact Test developed separately with the Ministry of Justice.

222. 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 IA, 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 UK.

223. 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.

224. The evidence suggests 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 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.

225. 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[97].
- 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.

226. 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.'

227. 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*

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

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.

228. 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 World Economic Forum 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.

229. 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 noted, among others, 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).

230. 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.

231. 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 G7, 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.

232. 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 G7, G20, FATF and in Europe to encourage other jurisdictions to take similar action.

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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

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

233. The measures in this IA implement international commitments the UK made at the 2013 G8 Summit.

234. We understand that the Better Regulation Framework Manual at time of writing sets out that measures to implement international commitments and obligations are out of scope of One In Two Out, but where there is a clearly prescribed minimum requirement or standard and the UK is implementing in a way that goes beyond this, that the additional burden over and above the minimum would be treated as in scope.

235. The G7 is an international forum that brings together eight global leaders (Canada, France, Germany, Italy, Japan, UK and USA, alongside the EU)[100] to address international issues and tackle the most pressing global challenges. The UK held the 2013 Presidency, and the Prime Minister hosted the annual Summit at Lough Erne in June of that year, where the agreements and commitments made by G8 leaders were set out in a formal Communiqué and documentation.

236. At the 2013 Summit all G8 members agreed a set of Action Plan Principles to prevent the misuse of companies and legal arrangements, and to publish Action Plans setting out the concrete action they would take to implement those Principles. All G8 members have published an Action Plan and are moving ahead with implementation.

237. The *Transparency and Trust* measures are drawn from the UK's Action Plan commitments drawn from the Action Plan Principles. Strong action to deliver reform that fully meets these commitments is now the minimum the UK must deliver to meet its international obligations.

238. The G8 obligations are binding in that the UK Government has made a public commitment to implement them; they are politically binding but not legally (or otherwise) binding. The G8 will hold the UK and other members to account in the following ways:
    - 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.
    - 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.

239. Failure to deliver against the G8 commitments would have significant impact on the UK's international standing within the G8 and more broadly, and would create substantial political

[100] Prior to 2014, the G8, including Russia.

embarrassment for the Government. However, the forum of the G8 does not set any minimum legal or other standard for implementation, so we judge these measures to be out of scope for OITO.

240. The UK must now act to deliver against its commitments, consistent with and directly relating to the commitments made in the G8 documentation. As mentioned, every G8 country has committed to an Action Plan, which sets out how they individually plan to take forward a set of Action Plan Principles agreed by all the G8 Leaders, and indeed reflecting the Communique.

241. We consider that the measures the UK will take forward are consistent with and directly in response to the commitments the UK has made. The G8 Action Plan Principles are set out below (though only the relevant provisions have been included). Alongside this the UK has set out a UK Action Plan (also below) to deliver the G8 Action Plan Principles. The UK's delivery of the G8 commitments will be judged against both of these plans.

242. The UK intends to:

- create and maintain a publicly accessible central registry of company beneficial ownership information; introduce sanctions to individuals and companies that fail to comply; and ensure that this information is readily available to national and international enforcement authorities. This is required to deliver points 1, 2, 7 & 8 of the G8 principles action plan and points 2, 3 & 9 of the UK Action Plan.
- remove the right to issue bearer shares and implement transitional arrangements to remove bearer shares from circulation. This is required to deliver point 5 and support the full implementation of point 1 of the G8 principles action plan and points 2 & 7 of the UK Action Plan.
- restrict the use of opaque arrangements involving company directors. This is required to deliver point 5 and support the full implementation of point 1 of the G8 principles action plan and point 7 of the UK Action Plan.

243. The UK is leading the developments in this area in order to persuade international adoption of these principles and methods. This is required to deliver point 8 of the G8 principles action plan and point 8 & 9 of the UK Action Plan.

244. Points 3, 4, and 6 of the G8 principles action plan and points 1, 4, 5 & 6 of the UK action plan are not directly related to corporate transparency and trust and are therefore being taken forward by other parts of Government, most notably HMT.

245. We consider the measures set out here are the minimum measures necessary to comply with the commitments set out in the G8 Action Plan Principles and UK Action Plan. These measures as a package are required to deliver all the G8 and UK Action Plan requirements on corporate transparency and trust.

246. The measures will be implemented in a way to minimise the additional costs to business. Extensive consultation with business and other interested parties has been conducted to ensure that the measures are implemented in the most effective way, without placing unnecessary additional costs on business.

247. We have carefully considered better regulation principles in developing these measures to implement the UK's international commitments, in accordance with good practice and the Better Regulation Framework Manual. This has included consideration of alternatives to regulation and attempts to minimise the costs to business while ensuring the efficacy of the policy interventions.

The evidence underpinning these attempts to evaluate and minimise the costs to business is covered elsewhere in this IA.

248. Although, we consider that 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 to implement the measures as described in this IA has a net direct cost to business per year of £4.48m.

A. G8 Action Plan Principles to prevent the misuse of companies and legal arrangements

Subject to our different constitutional circumstances, and understanding that a one-size-fits all approach may not be the most effective, the G8 endorses the following core principles that are fundamental to the transparency of ownership and control of companies and legal arrangements. These core principles, consistent with the FATF standards, are essential to ensure the integrity of beneficial ownership and basic company information, the timely access to such information by law enforcement for investigative purposes, as well as, where appropriate, the legitimate commercial interests of the private sector.

The G8 also commits to publish national Action Plans based on these principles that set out the concrete action each of us will take to counter money laundering and tax evasion. To ensure G8 members are held to account for their commitments, 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.

*1. **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.*

*2. **Beneficial ownership information on companies should be accessible onshore** to law enforcement, tax administrations and other relevant authorities including, as appropriate, financial intelligence units. **This could be achieved through central registries of company beneficial ownership and basic information at national or state level.** Countries should consider measures to facilitate access to company beneficial ownership information by financial institutions and other regulated businesses. Some basic company information should be publicly accessible.*

[…]

*5. **The misuse of financial instruments and of certain shareholding structures** which may obstruct transparency, such as bearer shares and nominee shareholders and directors, should be prevented.*

[…]

*7. **Effective, proportionate and dissuasive sanctions should be available** for companies, financial institutions and other regulated businesses that do not comply with their respective obligations, including those regarding customer due diligence. These sanctions should be robustly enforced.*

*8. **National authorities should cooperate effectively domestically and across borders** to combat the abuse of companies and legal arrangements for illicit activity. Countries should ensure that their relevant authorities can rapidly, constructively, and effectively provide basic company and beneficial ownership information upon request from foreign counterparts.*

B. UK Action Plan to prevent the misuse of companies and legal arrangements

The UK is committed to fully implementing the revised Financial Action Task Force standards in order to improve the transparency of the ownership and control of companies and legal arrangements. This is a matter of good corporate governance as well as a means to tackle a wide range of illicit activity. The UK is committed to taking the following actions to do this.

[…]

2. Ensure the Companies Act 2006 and UK Money Laundering Regulations oblige companies to know who owns and controls them, ***by requiring that companies obtain and hold adequate, accurate and current information on their beneficial ownership.***

3. Amend the Companies Act 2006 to require that this information is accurate and readily available to the authorities through ***a central registry of information on companies' beneficial ownership, maintained by Companies House. Consult on whether information in the registry should be publicly accessible.***

[…]

7. ***Review of corporate transparency, including bearer shares and nominee directors,*** *by the Department for Business, Innovation and Skills. This will start with the publication of a pre-consultation paper before September 2013.*

8. Support the ***Overseas Territories and Crown Dependencies*** *to publish Action Plans setting out the concrete steps, where needed, to fully implement the Financial Action Task Force Standards.*

9. ***Improve international cooperation*** *including the timely and effective exchange of basic and beneficial ownership information.*

10. Implementation of the measures will be through, and at the same time as, transposition of the 4th EU Money Laundering Directive and UK Money Laundering Regulations, changes to the Companies Act 2006, as well as through other relevant bilateral and multilateral agreements.[101]

J. Wider impacts

Statutory Equality Duties

249. This policy will primarily impact UK companies. A wider population might derive benefits from the policy as a result of reduced crime or an improved business environment. On analysing the potential impacts[102], we have no reason to anticipate a particular disproportionate impact on the basis of the key measures 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. We also have no reason to consider that those who act to control an appointed director, or the appointed directors who let that happen, disproportionately fall into one group or another.

250. Overall we have no reason to suspect that the following groups will be adversely or positively impacted by this policy in different ways:

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[101] Company Law is devolved in Northern Ireland. The UK government will work with Northern Ireland and the other devolved administrations to take forward these proposals as appropriate.

[102] Please see the separate Equalities Impact Assessments for the *Transparency and Trust* package for further discussion.

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

251. We therefore do not anticipate any equalities impact.

Economic Impacts

a. Competition impact test

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

253. All 3.19 million companies[103] would fall into scope under option 1, 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. There would also be an impact on an unknown number of companies who have directors controlled by others.

254. A complete prohibition of corporate directors could theoretically have a disproportionate impact on the sectors which currently use corporate directors, though we have no evidence detailing use of corporate directors by sector. Nonetheless, we do not consider, all other things being equal, the scale of the present policy change would be a factor in creating any sizeable competitive distortion for the sectors more commonly using corporate directors or having their directors controlled by others.

255. Under option 2 we propose a series of exceptions to a total of around 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.

256. With respect to both options 1 and 2, 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.

257. Our estimates indicate that a corporate director could be removed and replaced with a ‘natural person’ for around £162. 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.

258. The same minor cost disadvantage holds true for companies whose directors are currently under some control from others. If they were to change their arrangements they would at most experience a small cost of £73 for familiarisation and potentially some disruption to the tune of £193. Moreover,

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

we expect some competitive benefits to arise for the companies which change these relationships because their decision making will no longer be impeded.

259. 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

260. 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.

261. 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.

262. This policy will require change from those UK companies who currently have or act as corporate directors[104]. There is a default assumption across government that small and micro businesses[105] 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. We also understand from business representative bodies that a change to the use of corporate directors would not have a significant impact on SMEs.

263. 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"[106]. 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."

264. 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 business, particularly small and micro businesses relative to their larger and / or international competitors.

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104 To note that LLPs have corporate members.

105 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.

106 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

265. 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.

266. To consider the evidence in relation to the reforms around corporate directors, we have undertaken a preliminary analysis of the costs for small companies using the data obtained in the IFF Research company survey, weighted by the same methodology as for the overall figures. These estimates only use the 'best' estimate for the preferred option and for each cost estimate we have truncated the distribution at the same point as for the estimates for all companies.

267. We apply the Fame estimate that 98% of companies are small to the estimated means despite Companies House data suggesting that around 85% of the 67,000 companies with corporate directors file accounts as if they were small companies[107]. We have done this firstly because all the calculations underlying the company survey, including the weighting described in Annex A, are based largely on FAME population statistics. As a result, using data specific to corporate directors would be inconsistent and it would create a discrepancy between the SaMBA total cost estimate and the total cost estimate used in the body of this IA. Secondly, the Companies House data are based on accounts type so the share of small companies affected could be far higher and nearer to the FAME estimate of 98%. As such, these SaMBA figures are likely to overstate the cost to small businesses.

268. The RPC queried how SMEs would be affected in the consultation IA so we have now extended our analysis to monetise costs for SMEs. The survey data suggest that the mean costs for the small companies with corporate directors and for small companies which are corporate directors will be substantially lower than for large companies, as set out in the table below. Moreover, the total cost for small business is estimated to be £26m, which represents around 78% of the total cost to business (£34m). Given that small businesses represent 98% of the population, it is clear that these reforms will not be disproportionately costly for small businesses.

Cost	Company	Estimated Mean (£)	Total Cost (to nearest £m)
Familiarisation	**Small**	**20**	**£3m**
	Large	*487*	*£1m*
Removal and replacement for companies with corporate directors	**Small**	**133**	**£13m**
	Large	*1,815*	*£3m*
Removal and replacement for companies that are corporate directors	**Small**	**64**	**£6m**
	Large	*1,376*	*£2m*
Cost of disruption, reputational damage and lost advantages for companies with corporate directors	**Small**	**160**	**£5m**
	Large	*2,025*	*£1m*

107 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.

Cost of reputational damage for companies acting as corporate directors	**Small**	**128**	**£182k**
	Large	*550*	*£14k*
Total cost for small companies:			**£26.4m**

Table 22: Total costs for small business

269. Over and above the general indications that a small company is sufficient for opacity, we have no evidence to suggest that small companies particularly have directors under the control of others. Given the nature and lack of available statistics, we have no means to ascertain an estimate, nor to fully survey small businesses to arrive at a more definitive estimate.

270. 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 prohibition of corporate directors is relevant to them and it will help them to easily assimilate the compliance requirements where they do apply.

271. 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.

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

256. Factor	257. Consideration
Full exemption 258.	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 259.	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 260.	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.
	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

Temporary exemption 261.	therefore provide a means for illicit activity to continue unnecessarily.
Varying requirements by type and/or size of business 262.	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. 263.
Direct financial aid for smaller businesses	We do not believe that the costs of complying with this policy change per warrant direct financial aid. 264.
Opt-in and voluntary solutions	We have considered and discounted non-regulatory approaches in our IA, 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. 265.
Specific information campaigns/ user guides, training & dedicated support for small 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.

Table 23: Summary of small and micro business considerations

273. 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 or the increase in the accountability of those who control an updated definition of a shadow director is relevant to them and it will help them to easily assimilate the compliance requirements where they do apply.

274. 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

275. 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 or directors controlled by another tend to be located in rural areas).

b. Sustainable Development

276. 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 or directors controlled by another tend to be involved in sectors related to sustainable development).

Social Impacts

c. Health and well-being

277. 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.
278. We do not, however, see significant scope for impacts on safety at work, skills and education, or community facilities.

d. Human rights

279. 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 their directors, and the articles and protocols of the convention do not, in the main, seem relevant here.
280. Article 8 provides for a right to a private life; in seeking to promote the use of natural persons as appointed directors (as opposed to corporate directors or concealing external control), 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) and limited in scope to a number of key fields of information. Transparency in relation to company directors is a longstanding principle; provision of information has long been required in the UK and is also codified in the EU First Company Law Directive[108].

Justice Impacts

281. Following standard IA methodology this IA assumes 100% compliance with the policy. A Justice Impact Assessment Test has also been completed and is awaiting final clearance from the Ministry of Justice pending completion of the Criminal Offences Gateway process.

282. We intend to 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.

283. We anticipate however that most instances of non-compliance, particularly with relation to the reforms to the use of corporate directors, would be dealt with by Companies House through their

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[108] Please see the separate memorandum on the European Convention on Human Rights which accompanies the legislation required to take this forwards.

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.

284. Where we increase the accountability of those who control a company director, we consider there could be a deterrent effect which benefits the Criminal Justice System and reduces director misconduct. This break-even analysis is set out above.

Devolved Administration Assessment

285. There will be no apparent negative impact on devolved administrations.

286. 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:	Share of all companies acting as corporate directors:
• England and Wales – 2.2% • Scotland – 1.5% • Northern Ireland – 1.2% • UK – 2.1%	• England and Wales – 1.8% • Scotland – 1.3% • Northern Ireland – 0.7% • UK – 1.8%

Table 24: Summary of corporate director incidence in the UK

287. As for those who control company directors. we have no information as to their location across the UK. Although we have no means of assessing the impact on devolved regions, we again have no reason to believe that any region would disproportionately experience a negative impact.

Summary and preferred option with description of implementation plan

288. The preferred option is therefore to pursue the prohibition of corporate directors as the default position. 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. The preferred option also includes increasing the accountability of those who control an individual appointed company director.

289. 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. Moreover, the Net Present Value under option 2 (-£37.2m) is greater than option 1 (-£38.7m). The below table compares the costs and benefits of the two policy options.

Cost/ Benefit	Option 1 (blanket prohibition)	Option 2 (prohibition with some exceptions)	Which option is performs better?
Benefit			
B1. Benefits to government, individuals and business of a	£0.6m – reduced court costs from deterrent	£0.6m – reduced court costs from deterrent	Tie

reduction in illicit activities	effect of increased accountability for those who control company directors	effect of increased accountability for those who control company directors	
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	£24.9m £16.2m if have a CD £8.7m if co is a CD	£24.1m £15.7m if have a CD £8.3m if co is a CD	Option 2
C3. Any resulting disruption, reputational damage and loss of benefits	£9.6m – corporate directors £2m – increased accountability of those who control a company director	£9.2m – corporate directors £2m – increased accountability of those who control a company director	Option 2
C4. Familiarisation with the proposals	£4.1m – corporate directors £11.1m – increased accountability for those who control company directors	£3.9m – corporate directors £11.1m – increased accountability for those who control company directors	Option 2

Table 25: Summary of costs and benefits

290. In terms of the development of the implementation of the package, we should consider that 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.

291. 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.

292. 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 IA reflects the outcome of that call for evidence, as well as the other evidence gathering mechanisms outlined in this document.

293. In taking forward this policy change, we would seek to pursue the following high level implementation plan :
    - this reform necessitates primary legislation (with some secondary legislation)
    - 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 refined and legislation is passed. The plan will include transition arrangements and complement related proposed changes to company law. A potential framework for implementation would include :

i. Royal Assent of primary legislation
ii. Accountability of those who control company directors can be increased, depending on cases arising
iii. Exceptions from prohibition of corporate directors set out in regulations
iv. BIS/Companies House issue guidance
v. Companies House operate new systems for newly appointed directors (including for corporate directors and to raise awareness of directors' duties)
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

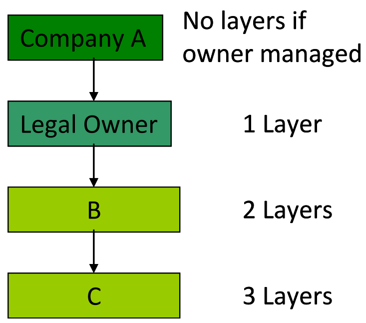
1. For the purposes of this Final IA, we built on the existing evidence base with the following:
    - an extension to our original company survey, consisting of largely qualitative questions
    - a series of focus groups consisting of businesses and trade associations

   The company survey was used to inform the way we treated the data collected in the original survey, whilst the focus groups were used largely to validate the estimates we produced in the consultation stage IA.

2. In relation to the original company survey, which was first used to inform the consultation stage IAs, 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 the proposed reforms on all UK companies. Respondents were asked questions to explore the likely cost impact of establishing a central registry of beneficial ownership, transparency around 'front' directors, the prohibition of corporate directors and the disqualification of certain directors.

Sampling

3. To identify the population of interest, we conducted a sample from the Fame[109] database, which is based on Companies House data. Companies were split into a 3x2 grid of quota cells based on corporate structure:
    - simple with 0-1 layers in the ownership chain;
    - reasonably complex with 2-3 layers of ownership (UK-owned, no trusts in the ownership chain); and
    - complex with over 4 layers and/or foreign ownership



   As well as company size:
    - micro and small (fulfil 2 of 3 from (i) Turnover < £6.5m; (ii) Balance sheet < £3.26m; (iii) Employees < 50); and
    - medium and large (fulfil 2 of 3 from (i) Turnover > £6.5m; (ii) Balance sheet > £3.26m; (iii) Employees > 50).

4. This sampling framework enabled our analysis to identify rigorously how costs would vary by company size and complexity. Ultimately, this shaped the proposed policy so as to minimise the burden on UK companies, whilst maximising the resulting crime reduction and economic growth enhancement.

Data Output

5. 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)[110]. The wages used were:

109 FAME database. 2013. Bureau Van Dijk Electronic Publishing.
110 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.

	ASHE wage data	Micro and small companies	Medium and large companies
Senior Management	Chief executives & senior officials	£48.20	£57.18
Middle Management	Corporate managers and directors (excluding chief execs & senior officials)	£18.33	£23.89
Administrative Staff	Administrative & Secretarial Occupations	£10.78	£11.59

Table A1: Wage rates used in the company survey

6. The estimated mean was weighted according to the original Fame sample below, such that more weight was given to cells with a greater number of companies. More specifically, 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. As a result, the overall mean is largely driven by the estimates from 'small, simple' companies.

Weighting grid	Simple	Reasonably complex	Complex	Total
Small / Micro	93.5%	2.9%	1.9%	98.3%
Medium/ Large	0.92%	0.28%	0.55%	1.74%
			TOTAL	3,187,112

Table A2: Fame data split by company size and complexity

B. Issues with the original survey

7. 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. In fact, IFF Research explained to BIS that some respondents struggled to answer the questions and some had varying interpretations of the questions.

8. We identified a number of striking distributions across all 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. For instance, the question relating to familiarisation costs for the creation of a register of beneficial ownership information, yielded the following distribution of responses:

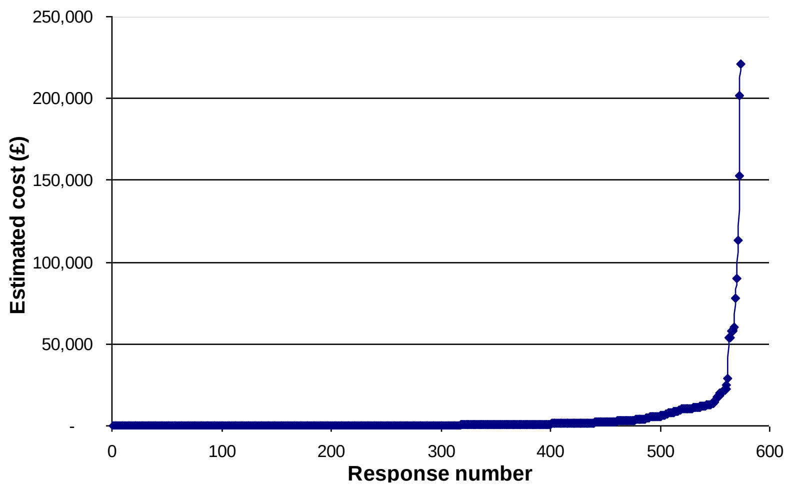


Figure 1: Distribution of responses on familiarisation costs related to beneficial ownership (people with significant control).

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

Table A3: Familiarisation costs related to beneficial ownership (people with significant control)

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 analysis of these respondents showed no relationship between cost[111] and size (based on turnover, employees and assets) and complexity (based on the number of layers of share ownership).

10. If we compare the cost estimates produced by the present survey to other comparable cost estimates, they are substantially higher:

Source	Cost	Cost estimate per company	Company Survey Raw Mean
Companies House[112] - Filing Requirements	Familiarisation	20 minutes = £6[113]	£1087 (Beneficial Ownership Familiarisation)
PWC – Admin Burdens Exercise[114]	Returning a form to Companies House	£12.39[115]	£160 (Annually providing information to Companies House)

Table A4: Cost estimate comparisons

C. The updated evidence base for the final Impact Assessment

11. IFF Research conducted a follow-up survey with 43 of the 574 respondents to interrogate their original answers and to identify whether their answers would change in the light of new policy detail. Although the follow-up survey used a relatively small sample, IFF Research was able to conduct in depth interviews with the respondents from the original survey.

12. We specifically targeted interviews at the respondents who gave either zero, low (under £5) or high (top 10%) quantitative estimates in the original survey. In total, we received 31 responses to the beneficial ownership questions and 12 responses to the corporate directors questions. Across all the questions we aimed for roughly a 50:50 split between 'high' and 'low' respondents.

13. Ultimately, the research findings guided us in developing the methodology for this Final IA and determined the way in which we treated both the *low* and *high* respondents.

14. For the reasons set out below, the new survey indicated the original survey questions lacked the specificity required to elicit fully informed answers consistently. We believe these issues have had an effect on the robustness of the responses and therefore on their overall suitability for unqualified use

111 Although there was a slight tendency for those giving high responses to be 'large' – around 60% were.
112 Detail in the cost benefit analysis within consultation on Companies House Filing Requirements.
113 The wage cost used was £19 – the mid point between the median wage and the wage of a company director
114 This study excluded policy costs, which are typically ten times the admin costs
115 Uprated from 2007 prices to 2013 prices

in our analysis of the costs. The issues we identified with the survey are detailed below for both the beneficial ownership policy and the corporate directors policy. We faced the same issues in the survey with both policies so it is worthwhile discussing them jointly.

<u>Reasons companies gave high wage cost estimates</u>

15. Reasons included :
    - Misinterpretation of the questions (e.g. provision of annual cost estimates rather than for a single procedure. This gave estimates which were many times larger than they should have been)
    - Companies provided initial upper estimates, which they expected to fall over time
    - Double counting (e.g. companies including compliance costs in their familiarisation cost estimate as well as reporting it separately)
    - Reporting the total number of hours for all staff rather than a break down by staff level. This raised cost estimates substantially if the staff hours were recorded as senior staff time with their considerably higher wage relative to admin staff time for instance.

16. In addition to the four types of mistakes we commonly encountered from respondents in the original survey, respondents often revised down their original estimates when they were given new policy information:
    - 54% (of the 24 companies which were asked how their estimates would change) revised down their estimates on beneficial ownership from an originally 'high' estimate.
    - 29% (of the 17 companies which were asked how their estimates would change) revised down their estimates on corporate directors, whilst 65% stood by their original 'high' estimate.

    This finding reinforces our use of the four types of mistakes to inform our treatment of the data to remove a number of the extreme values. If <u>all</u> companies had revised down their estimates, we might have considered removing more of the outliers but we have adopted a more moderate approach here.

17. We by no means considered <u>all</u> the 'high' responses received in the first company survey invalid. However, in the light of the above we targeted the removal of high estimates primarily from 'small simple' companies, as described below - table 6 shows the highest estimates we used were still in most cases several thousand pounds for 'large complex' companies. Although the second company survey did not entirely determine how we treated the data, it did indicate to us that a proportion of cost estimates were plausible and some implausible.

<u>Quotes from 'high cost' respondents:</u>

In terms of familiarisation with the beneficial ownership proposals, once companies were given new policy detail they revised down their estimates considerably. One respondent, who previously estimated it would take one senior manager five hours and £10,000 in additional (legal) costs said:

That would obviously take less if it could all be done by this [13 pages of guidance for familiarisation] *and less digging had to be done and to make the explanation up front. Should reduce it by at least 25% if I have to give a number.*
[micro/small, simple structure]

Similarly, a representative from small complex company revised compliance cost estimates down substantially after new policy information made the respondent realise compliance would be less onerous than originally expected:

Those times and costs would go down considerably. Down by 90% because all the work's done for you. They're just saying 'we're here, hi!' [micro/small, complex structure]

Reasons companies gave low wage cost estimates

18. Reasons included:
    - Companies misunderstood and thought the reforms were not relevant to their company (particularly for beneficial ownership) so incorrectly assumed they would not undergo any cost for familiarisation or compliance.
    - Difficulty in answering the hypothetical questions (e.g. most companies answering the corporate directors questions did not have a corporate director, so chose to give low responses.)

19. In the light of new policy information, 79% (of the 19 companies which were asked how their estimates would change) did not revise their estimates on *beneficial ownership*, whilst the remaining 21% revised up their original 'low' estimate.

20. By contrast, 63% (of the 19 companies which were asked how their estimates would change) revised up their estimates on *corporate directors*, whilst the remaining 37% stood by their original 'low' estimate.

<u>Quotes from 'low cost' respondents:</u>

In the case of companies familiarising themselves with the beneficial ownership proposals, a typical response from a respondent who already knew their company's beneficial owner and understood the associated principles was:

'We have 2 shareholders with 50% share each, they're both directors of the company, they both live together and one of them is me. So we are both well aware of the changes and we don't really need to do much else.' [micro/small, reasonably complex structure]

Another comment related to a small simple company responding to a request was:

'We're only a small private owned company with a couple of shareholders so beneficial ownership is not really much of an issue. It would be one person (i.e. me) writing a letter I suppose, or responding to an email - no systems or infrastructures envisaged.' [micro/small, simple structure]

<u>Business Focus Groups</u>

21. Alongside the follow-up company survey we also held a number of focus groups with around 30 companies and 6 business representative organisations (listed in Annex B), which together represent at least 240,000 companies and many hundreds of thousand employees. These groups were orientated around validating or disproving the estimates we provided in the consultation stage IAs.

22. In the case of the beneficial ownership, of the six distinct types of cost, five of them were largely validated by the groups. Collation, processing and storage costs were only partially validated because some companies thought if paper records were required costs could be higher. Although the attendees found it difficult to place an accurate figure on how much it would cost them to follow a certain procedure, in general they thought our estimates seemed to be reasonable for small simple companies (around 94% of the population) but costs could be considerably higher for larger and more complex companies. Given that the figure was already weighted by the size and complexity of the company (as detailed below), we considered it to be consistent with the types of comments the groups made.

23. As regards the proposals related to corporate directors, a number of companies thought that we had focussed our analysis of the costs too heavily upon the procedures and processes they would have to follow. The consensus was that the majority of the costs would come from the legal advice and recruitment costs associated with the proposals so we included them in the final IA.

D. Methodology for the Final Impact Assessment

24. Despite its flaws, the original representative survey provides the most comprehensive dataset available, and we believe there is value in processing it to produce realistic and duly qualified cost estimates. The results from the original company survey, particularly at the upper end of the distribution were surprising. Firstly, they didn't fully accord with the discussions we had with stakeholders and secondly it was not clear why the estimates were so high.

25. For the consultation stage IA we also adopted a truncated mean approach (i.e. using only feasible values in the mean calculation) to adjust for extreme values. The RPC commented that some further analysis around how the estimates differ if the data were processed differently, would be informative so we have refined our approach.

26. For this final IA, we were able to gather more evidence from an additional survey and business focus groups to build on the evidence we already had. Indeed, the analysis and evidence gathering for this IA have been in development since July 2013 and we have pursued every relevant evidence source fully. The new evidence enabled us to truncate the data on the basis of this new information. For instance, the second company survey suggested that the extreme 'high' cost estimates commonly suffered from double counting and misinterpretation. Put simply, these extreme estimates were found to be unfeasibly high and not appropriate to include in the dataset. This validated our approach of processing the data to arrive at realistic estimates.

27. Therefore, we have truncated the mean (i.e. used only feasible values in the mean) to adjust for extreme values. Truncation is a statistical technique which is commonly applied to survey data. On this occasion, we utilised a more robust technique to identify where to truncate and we truncated a lower proportion of the data than in the consultation IA and we utilised a more robust technique to identify where to truncate.

Treatment of High Wage Cost Estimates

28. It is necessary to exclude implausible or unverifiable estimates at the opposite end of the distribution. Similarly to the consultation IA, we used a truncated mean for each survey question relating to costs. However, on the basis of the new evidence we gathered for this IA, we have revised our truncation method as follows:

    v) We trimmed the weighted values (rather than the unweighted values, as per the Consultation IA) to target more effectively the implausibly high estimates, which were biasing our estimate of the mean upwards. This also enabled us to trim a lower share of the data relative to our previous approach in the consultation IA.
    vi) We used a robust statistical technique (based on analysing the coefficient of variation[116]) to identify the specific point at which to truncate the mean.

29. To explain (i) further, as detailed above, each observation in the sample was weighted according to how commonly its company type (based on the 3 x 2 grid in table 2) was seen in the population. As a result, an estimate given by a small simple company was given a much greater weight than one given by a large complex company. Once these weighted values are totalled and divided by the number of observations, this ultimately produces a mean that is representative of the whole population.

116 The coefficient of variation is a measure of sampling error, which takes account of the size of the estimate, giving a relative measure of precision. It is calculated as the standard error divided by the mean. Lower figures imply a more precise estimate of the mean. Standard errors have been calculated taking proper account of the fact that we are using a weighted and truncated mean, such that the highest observations still contribute to the standard error.

30. By trimming weighted values, we are able to remove most efficiently the observations, which are distorting the mean upwards. For instance, if a small simple company were to offer a cost estimate of £1,000 because that type of company is given a large weighting, this single response would drag up the mean substantially. On the basis of our second company survey, the relatively high responses were called into question for the reasons detailed above. It would therefore be sensible to remove the responses, which were incorrectly raising the mean beyond a feasible value. Moreover, adopting this approach helps to minimise the number of observations that are removed from the dataset.

31. With regard to (ii), for each quantitative question we plotted the coefficient of variation for each potential trim, as shown below for the cost of removing and replacing a corporate director. Adopting this approach rather than simply eyeballing the distributions to identify where to trim, gives us a robust objective rule which is founded upon minimising the sampling error. Trimming on a purely statistical basis, we should trim up to the lowest coefficient of variation (i.e. the global minimum). However, the estimated means produced on this basis produced results which were inconsistent with the costs we would expect based on our latest focus groups and company survey.

32. For this reason, we have adopted a second trimming approach, which trims after the next substantive fall in the coefficient of variation (i.e. the next lowest local minimum). This allows us to arrive at an estimate, which is more consistent with the figures which were validated by industry in our focus groups and company surveys. In the chart below, the vertical red line on the left is the suggested trim based on the first method (1%) and the vertical red line on the right is the suggested trim based on the second method (8%).

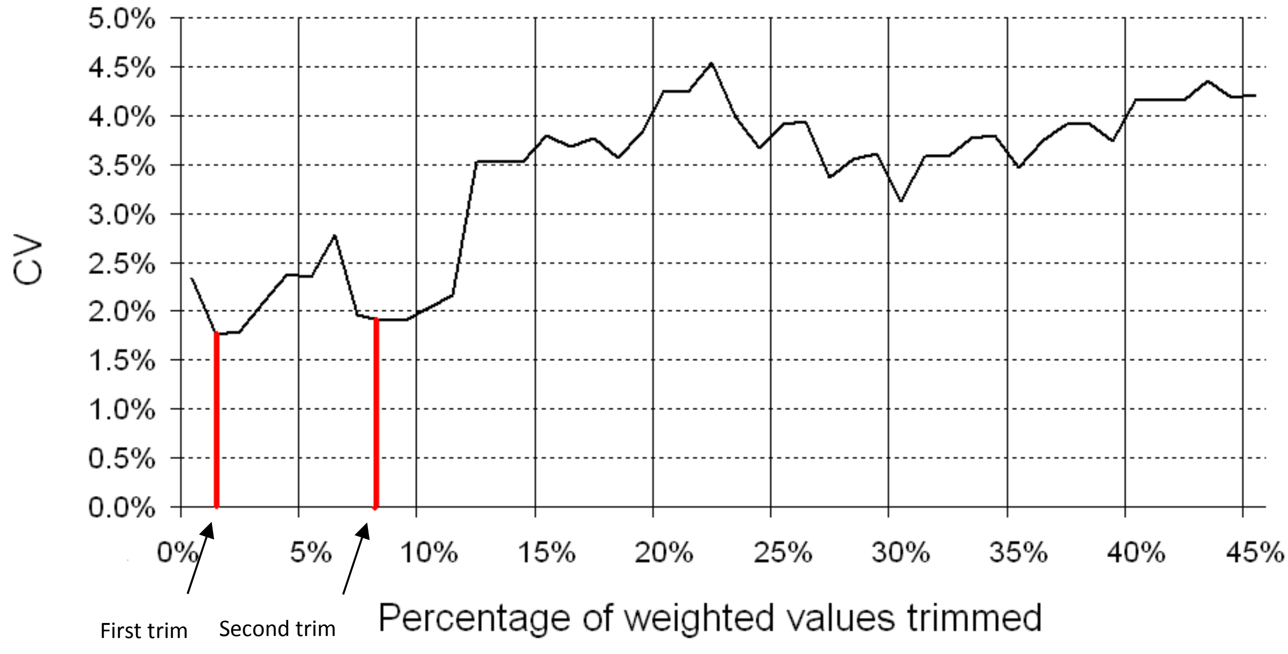


Figure 2: Coefficient of variation chart for the cost of removing and replacing a corporate director

33. To provide some sensitivity analysis around these estimated means, we used the following estimates:
    - Low: Mean from the second trimming approach (local minimum)
    - High: Midpoint between the two trimming approaches
    - Best: Mean from: (Percentage of remaining data after second trim x Second trimming approach mean) + (Percentage of data trimmed under second approach x Mean from first trimming approach)

For instance, the best estimate in the case of removing and replacing a corporate director was calculated as follows: (93% x £58) + (7% x £191) = £67. This essentially assumes that for 93% of companies, £58 would be a reasonable estimate whilst £191 would be appropriate for the remaining 7%. The low estimate would be £58 (i.e. the second trim) and the high estimate would be £125, calculated as a mid-point between the first and second trims.

34. To explain our thinking further, based on the results of the second company survey and the focus groups, we felt we had to trim the data to arrive at reasonable cost estimates. Of the two trimming approaches we used, the estimates derived from the first trim were not reasonable based on the wider evidence we gathered. For this reason we applied the above sensitivity analysis, which uses both trims, to arrive at a range of estimates that fitted closely with this discussions we had with business.

35. The table below displays where the coefficient of variation led us to trim under the two chosen methods. We also provide the cost estimates for these two methods in addition to the low, best and high wage cost estimates, used in the calculations for this IA. These estimates are in line with the BIS evaluation of the Companies Act 2006[117] in which 33% of the companies surveyed spent under 10 hours in total complying with the whole Companies Act over the course of three years (at the very most around £480 in wage costs).

	First trimming approach		**Second trimming approach**		**Wage cost estimates**		
Cost	**Trim**	**Cost**	**Trim**	**Cost**	**Low**	**Best**	**High**
Familiarisation with the beneficial ownership reforms	6%	£111	13%	£48	£48	£56	£80
Identifying and collecting information about the beneficial owner.	1%	£45	8%	£5	£5	£9	£25
Responding to a request about your beneficial ownership.	4%	£35	13%	£7	£7	£11	£21
Collation, process and storage of beneficial owners data	1%	£53	9%	£9	£9	£13	£31
Updating beneficial ownership information annually	4%	£42	14%	£9	£9	£14	£26
Providing beneficial ownership information to a central register annually.	3%	£40	14%	£9	£9	£13	£24
Familiarisation with the proposal to prohibit corporate directors.	3%	£43	13%	£8	£8	£13	£26
Removing and then replacing a corporate director.	1%	£191	7%	£58	£58	£67	£125
Removing or updating a corporate directorship.	1%	£110	9%	£32	£32	£39	£71
Disruption/reputational damage to companies with corporate directors after prohibition	1%	£290*	1%	£95	£95	£193	£290
Disruption/reputational damage to companies which are corporate directors after prohibition	1%	£260*	1%	£11	£11	£135	£260

117 http://www.bis.gov.uk/assets/biscore/business-law/docs/e/10-1360-evaluation-companies-act-2006-volume-1.pdf

**For the costs related to disruption and reputational damage for corporate directors we adopted a different methodology. Under the first trimming approach we trimmed the weighted data with any zeros re-coded to the lowest recorded value; this formed the 'high' estimate. Under the second trimming approach we trimmed the weighted data including any zero values; this formed the 'low' estimate. The 'best' estimate was calculated as a midpoint between the two.*

Table A5: Wage cost estimates and trimming positions

36. However, as noted above, we trimmed on the basis of weighted cost estimates. Since around 94% of companies were 'small, simple', any estimate from a company of this type would be weighted relatively heavily. As a result, if a 'small, simple' company gave a relatively high cost estimate, combined with their large weighting, their estimate would be more likely to appear at the top of the distribution. It would therefore make it more likely to be trimmed from the dataset as an extreme value.

37. Our *a priori* knowledge of the likely costs as well as our evidence base (second company survey, business focus groups and consultation) suggested that, particularly for 'small, simple' companies, costs should be relatively low compared with larger more complex companies. This was largely because compliance would be far more straightforward. For this reason, it was deemed plausible that any 'small, simple' estimates at the upper end of the distribution were less reliable and hence correctly caught by the trimming methodology. By contrast, where possible, we avoided removing estimates from larger, more complex companies because compliance could be considerably more time consuming.

38. The table below compares the maximum cost estimates provided by 'small, simple' and 'large, complex' companies, when the data are untrimmed and at the second trimming point[118]. To explain further, iteratively trimming one percent of the data at a time will gradually remove the highest weighted values. As more data points are removed this reduces the threshold level for the maximum estimate, which feeds into the mean. However, the impact will differ by company type because generally the companies with the largest weighting (i.e. 'small, simple') will have their highest cost estimates trimmed first.

39. It is clear to see that at the second trim, the maximum allowed estimate for 'small simple' is substantially reduced. For instance for beneficial ownership familiarisation, the maximum untrimmed estimate for a 'small simple' company was £48,200 but after trimming, the maximum allowed estimate was £59. The maximum estimate for a 'large complex' company falls substantially but remains almost 100 times as large as the 'small simple' estimate. More specifically, it falls from £88,244 to £5,718.

40. This demonstrates that under our trimming method, we are primarily targeting the removal of the 'high' estimates from 'small simple' companies. However, we are not removing proportionately as many of the estimates from 'large complex' companies, for which costs might be substantially higher. This is in line with the evidence we gathered from the business focus groups and the follow-up company survey.

Cost	**Untrimmed**		**First Trim**		**Second Trim**	
	Max recorded estimate		**Max allowed estimate**		**Max allowed estimate**	
	'Small simple'	'Large complex'	'Small simple'	'Large complex'	'Small simple'	'Large complex'
Familiarisation with the proposed beneficial ownership reforms	£48,200	£88,244	£236	£13,447	£59	£5,718

[118] We provide only the data for the second trim for illustrative purposes because this shows the largest change from the untrimmed data.

Identifying and collecting information about the beneficial owner.	£1,475	£6,407	£386	£6,407	£22	£2,287
Responding to a request about your beneficial ownership.	£5,398	£4,864	£96	£4,864	£12	£1,372
Collation, process and storage of beneficial owners data	£8,819	£34,678	£3,889	£34,678	£138	£18,230
Updating beneficial ownership information annually	£2,699	£4,735	£96	£4,735	£14	£1,372
Providing beneficial ownership information to a central register annually.	£12,050	£5,248	£96	£5,248	£12	£1,946
Familiarisation with the proposal to prohibit corporate directors.	£12,050	£34,714	£145	£2,765	£15	£1,394
Removing and then replacing a corporate director.	£5,398	£24,811	£964	£24,811	£145	£5,718
Removing or updating a corporate directorship.	£2,892	£24,811	£578	£24,811	£48	£8,107
Disruption/reputational damage to companies with corporate directors after prohibition	£80,000	£50,000	£1,000	£50,000	-	-
Disruption/reputational damage to companies which are corporate directors after prohibition	£7,000	£15,000	-*	£15,000	-	-

**Applying the same method as for the other questions, in this case, there were so few responses that trimming just 1% of the data removed all 'small, simple' values. As a result, we only applied one trim.*

Table A6: Maximum allowed estimates under trimming method

41. To demonstrate the impact of trimming on the means for different company type, for illustrative purposes, table 8 provides the means for 'small simple' and 'large complex' companies. Naturally, by trimming, the means for both company types fall. However, the mean for 'small simple' companies falls substantially more than for 'large complex' companies. For instance, the mean familiarisation costs related to beneficial ownership fall from £1,098 to £46 for 'small simple' companies. By contrast, for 'large complex' companies, the mean falls from £1,858 to £946. This demonstrates the types of mean we arrive at under the trimming approach compared to the means we would arrive at without trimming.

Cost	**Untrimmed**		**First Trim**		**Second Trim**	
	Mean		**Mean**		**Mean**	
	'Small simple'	'Large complex'	'Small simple'	'Large complex'	'Small simple'	'Large complex'
Familiarisation with the proposed beneficial ownership reforms	£1,098	£1,858	£133	£1,102	£46	£946
Identifying and collecting information about the beneficial owner.	£70	£296	£41	£296	£5	£228
Responding to a request about your beneficial ownership.	£181	£204	£39	£204	£7	£156
Collation, process and storage of beneficial owners data	£88	£350	£55	£350	£11	£230
Updating beneficial ownership information annually	£144	£205	£45	£205	£10	£171
Providing beneficial ownership information to a central register annually.	£214	£205	£43	£205	£10	£172
Familiarisation with the proposal to prohibit corporate directors.	£252	£542	£53	£219	£7	£191
Removing and then replacing a corporate director.	£335	£635	£205	£635	£73	£442

Removing or updating a corporate directorship.	£171	£725	£120	£725	£32	£495
Disruption/reputational damage to companies with corporate directors after prohibition	£1,490	£515	£70	£515	-	-
Disruption/reputational damage to companies which are corporate directors after prohibition	£120	£354	-*	£354	-	-

**Applying the same method as for the other questions, in this case, there were so few responses that trimming just 1% of the data removed all 'small, simple' values. As a result, we only applied one trim.*

Table A7: Estimated means under second trimming method and untrimmed

Treatment of Zero Wage Cost Estimates

42. It is also necessary to consider how to treat zero values. A large number of survey respondents answered that there would be zero costs arising, for example from the proposed policy changes, as detailed in section C. 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. For this reason, we re-coded these observations such that they were set to the minimum recorded positive estimate. For instance, if the minimum cost estimate any company in the sample gave was £5, all zero responses would be re-coded to £5. This is a reasonable approach, which reflects the assumption that all companies would have to undergo some cost. It also minimises the bias to the dataset, which we would otherwise have introduced by re-coding the values to an higher value, which is not supported by any evidence. This will raise the estimate mean cost relative to simply including zero cost values in the calculation of the mean.

43. The main benefit of not removing the zero values from the sample as we did in the consultation IA is that we are not losing such a substantial number of observations from the sample. Since we need to trim at the top end of the distribution, also removing the zero responses from the bottom end would dramatically reduce the sample size. As shown in the below table, there was considerable variation in the number of zero responses for each question but on average around 30% of observations were zero.

	Number of zero observations	**Zero observations as % of all observations**
Cost of company familiarisation with the beneficial ownership reforms	67	12%
Cost of identifying and collecting information about the beneficial owner.	387	67%
Cost of responding to a request about your beneficial ownership.	185	32%
Cost of collation, process and storage of beneficial owners data	162	28%
Cost of updating beneficial ownership information annually	119	21%
Cost of providing beneficial ownership information to a central register annually.	76	13%
Cost of ensuring familiarising with the proposal to prohibit corporate directors.	186	32%
Cost of removing and then replacing a corporate director.	147	26%
Cost of removing or updating a corporate directorship.	165	29%
Cost of disruption/reputational damage to	534	93%

companies with corporate directors after prohibition		
Cost of disruption/reputational damage to companies which are corporate directors after prohibition	551	96%

Table A8: Zeros observations in the sample

Treatment of Additional Cost Estimates

44. 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 Research 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.

45. In the follow up study, IFF Research further interrogated the additional costs. Companies generally considered these costs to arise from legal and accountancy advice for the beneficial ownership questions and from recruitment for the corporate directors questions. In the light of new evidence, the majority of companies stood by their original estimate but similarly to the wage cost estimates, a number of companies gave comments that cast some doubt over the validity of the highest estimates. The main issues we noticed were:
    - some companies commented that their additional cost estimates were very much a 'worst case scenario';
    - some companies mentioned that they might not in fact incur additional costs; and
    - a few companies noted that on reflection they may have included some staff time in their additional cost estimates – meaning there was some double counting.

46. For instance, one 'high cost' additional cost response, came from a company which previously estimated additional costs of £5,000. In the second survey they revised their answer, no longer feeling that it would cost their company anywhere near this, and would be more likely to cost them around £100. This was because, on further discussion, they felt that they would not need to incur legal fees for this particular task.

    'I think the most likely outcome is that the cost will be negligible by which I mean less than £100 and it would be an awful lot to take it £5,000 to be honest on the basis that there's no cost in terms of fees, so we're only talking about internal time.' [medium/large, simple structure]

47. In the case of additional costs for the removal of a corporate director, for which cost estimates varied from, £5,000 to £100,000, one company considerably revised their estimate:

    'On reflection, that feels a little bit high really. Maybe I didn't quite understand the question. I can't possibly think how I got to these figures.' [medium/large, simple structure]

48. On this basis, it seemed sensible to truncate the dataset using the same method that we applied to wage costs. The only difference in method for our treatment of additional costs was the inclusion of zero values. In this case, we consider it an entirely valid response for a company to state that it would not undergo optional additional costs because it could comply with the proposals using in house resources.

49. The table below details where we chose to trim and the resulting estimated mean. These estimates are in line with the BIS evaluation of the Companies Act 2006[119] in which 64% of the companies surveyed spent under £500 in total on additional costs to comply with the whole Companies Act over the course of three years.

	First trimming approach		Second trimming approach		Additional cost estimates		
Cost	**Trim**	**Cost**	**Trim**	**Cost**	**Low**	**Best**	**High**
Company familiarisation with the proposed reforms	4%	£111	12%	£25	£25	£36	£68
Identifying and collecting information about the beneficial owner.	1%	£65	6%	£15	£15	£18	£40
Responding to a request about your beneficial ownership.	1%	£87	6%	£15	£15	£19	£51
Collation, process and storage of beneficial owners data	1%	£37	4%	£11	£11	£12	£24
Updating beneficial ownership information annually	1%	£113	4%	£27	£27	£30	£70
Providing beneficial ownership information to a central register annually.	1%	£63	4%	£21	£21	£22	£42
Familiarisation with the proposal to prohibit corporate directors.	1%	£76	7%	£11	£11	£16	£43
Removing and then replacing a corporate director.	1%	£376	6%	£77	£77	£95	£226
Removing or updating a corporate directorship.	1%	£182	6%	£39	£39	£47	£110

Table A9: Additional cost estimates and trimming positions

119 http://www.bis.gov.uk/assets/biscore/business-law/docs/e/10-1360-evaluation-companies-act-2006-volume-1.pdf

Annex B – Focus Groups Attendance List

1. As set out in Annex A, alongside the follow-up company survey we also held focus groups with around 30 companies and 6 business representative organisations which together represent at least 240,000 companies and many hundreds of thousand employees. These focus groups were orientated around validating or disproving the estimates we provided in the consultation stage IAs.

2. The first focus group was aimed at business, particularly small and medium sized businesses. To reach individual businesses, we asked the representative bodies to encourage their members to attend. We also worked with Companies House to invite businesses; the list below reflects those who were ultimately able to come to the discussion.

3. The second focus group was aimed at business representative bodies. We invited a range of bodies to attend, the list below reflects those who were ultimately able to come to the discussion and where possible we engaged though alternative means with those who were not able to attend.

Companies in attendance	Business representative organisations in attendance
Abell Morliss International	ICSA - Compliance
Armess	BCC
Assoc of Company Registration Agents	ICAEW
Bank of America Merrill Lynch	Law Society
Broadhead Accountants	ICSA Software International
Capita Asset Services	ICSA - Customer Services
Capita Asset Services	
Centrica PLC	We have separately discussed these policy proposals and analysis with a range of other business representative organisations including the CBI and IoD.
Charles Russell LLP	
Chettleburgh's Ltd	
Company Registrations Online	
Creditsafe	In total, these business representative organisations represented at least 240,000 companies and the views of hundreds of thousands of employees.
Dun and Bradstreet and BIPA	
Entone Group	
Experian	
Jordans Trust Company Ltd	
LegalinX-7Side	
MSP Secretaries	
Naylor Wintersgill	
Penfold & Redstone Ltd	
PWC Tax	
RBJ Tax & Accountancy Services	
Slaughter and May	
Stanley Davis & Co.	
The London Law Agency Ltd	
Thomson Reuters	
Thrings Solicitors	
Ward Williams	
Wilder & Coe Ltd	

Annex C – Corporate transparency at the G8

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. These Action Plans were based on common Action Plan Principles. 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. As set out in the main text, the actions set out in this IA are required to deliver Principle 5 and support the full implementation of Principle 1 of the G8 Action Plan Principles action plan and to deliver point 7 of the UK Action Plan.

4. **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[120].**

5. In July 2013, a month after the G8 Summit, 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 commitments. *"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.[121]"*

120 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.
121 BIS (2013) *Transparency and Trust discussion paper* https://www.gov.uk/government/consultations/company-ownership-transparency-and-trust-discussion-paper.

Annex D – The UK legislative framework around company directors

1. Much of the regime around UK company directors is set out in primary legislation. Changes therefore tend to require primary legislation.

2. Currently, as set out in the Companies Act 2006, all registered private companies must have one director, and all registered public companies must have two. The Act does not provide for the means of appointing directors, leaving this to the company and their articles of association[122], but it does require the registration of certain particulars of directors. Key information relating to those directors must be held by the company and provided to the registrar at Companies House, who must also be updated if the information changes. Certain particulars are available on the public record.

3. The Companies Act 2006 sections 163 (for individuals) and 164 (for corporate directors and firms) sets out those key pieces of information and some further specifications; essentially a company director's name, service address, country of residence, nationality, occupation and date of birth will be on the record. An individual director's residential address is also required, but Companies House will not make this information public. There is therefore a degree of transparency around company directors.

4. At the same time, the Companies Act 2006 sets out a number of duties which apply to directors of companies. These had evolved over time in case law and were set out in statute for the first time in 2006, where they include the duty to promote the success of the company, exercise independent judgement, exercise reasonable care, and avoid conflicts of interest (among others). They are (generally) fiduciary duties, and are owed to the company. Some further duties have not been codified, such as the duty of confidentiality.

5. Directors also have a number of powers which are given to them by the company's articles, and which they are entitled to delegate as they see fit as part of managing the company.

6. Limited Liability Partnerships (LLPs) are another class of corporate structure in the UK which 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.

Corporate Directors

7. Before the Companies Act 2006, companies could appoint other companies (or other legal persons) as directors without restriction – as corporate directors. 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'). For LLPs, corporate members can be appointed without any corresponding requirement for at least one 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.

8. 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.

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122 The Companies Act 2006 does not provide for the means of appointing directors for private companies, though there are voting requirements detailed for the appointment of public company directors in section 160.

9. 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 companies.

10. 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. About 76,000 companies act as a corporate director, and there are around 100,200 corporate directorships.

11. 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. Moreover, our company survey[123] 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.

12. Companies House data indicate that over 85% of the 67,000 companies with corporate directors file accounts as if they were small companies[124]. 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, they might be more likely to gain business benefits, for instance efficiency within large group structures, from the use of corporate directors[125].

13. 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 charitable companies to use corporate directors, which was noted by respondents to our consultation. Interested parties reported that charitable companies sometimes find it easier to engage expertise on their boards using corporate directors. The problem therefore warrants a solution which is workable for business, and proportionate.

Natural Person Directors

14. All appointed directors have the same status under the law. But in practice an individual director can act irresponsibly as a 'front' for someone else who controls their functions as a director. In doing so, the director might well breach their duties.

15. However, there is no clarity around identification of controlled directors, nor of those who control them. The problem under consideration relates to a range of undesirable behaviours which are a product of the current system, but there is no simple means of determining their prevalence. At the same time, there are similar behaviours that are not necessarily undesirable; for instance, directors seeking wider views and operating in a broader context is part of legitimate business function.

16. There are some striking case studies involving illicit activity based on opaque company director engagements, of interest for illustrative purposes. For instance, there was extensive coverage in

123 BIS/IFF company survey 2013 (see costs sections and Annex A).
124 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.
125 See also Small and Micro Business Assessment in Wider Impacts section.

2012[126] of front directors being used with allegations of tax evasion. Comments from the Guardian include *"James Turner, of Turner Little in York, offers nominee directors in Belize and says: "They won't even know that they were a director, they just get paid.[127]"* The NGO Global Witness[128] has also linked UK companies with opaque director arrangements to significant money laundering cases, and highlighted the use of unsuspecting individuals as 'front' directors. To gauge a wider sense of this behaviour, a simple internet search of 'company director services' particularly alongside words like 'nominee' or 'discretion' or 'protect identity' will reveal the range of (legal) services available.

17. There are also some proxy measures we can consider. For instance, where an individual director is registered at Companies House as having multiple directorships, this may be a ground to suggest that the director is not fully involved in each, and has let their name be used on the register while control lies elsewhere. Of course a high number of directorships could arise for a number of reasons, for instance in large group structures, which are not related to illicit activity. (At the same time, illicit activity could be undertaken through a company where one front director conceals control for one individual only).

18. Nevertheless, to understand the extent of what the current system does allow, it is worth noting that 1,223 directors currently act as the director of more than 50 companies, while 6,150 directors currently act as the directors of more than 20 companies. Assuming the directorships are not linked, and there is at most one 'front' director per company board, this equates to at most 8.6% of all UK companies having such a director. The latest Companies House data show there are around 3.19m[129] companies on the register and 5.67m directors – suggesting an average of 1.8 directors per company. This more conservative assumption gives a figure of 4.8% of all UK companies having such a director. Notably, despite being present in (at most) 8.6% of all companies, 'front' directors feature in many cases of crime using companies as vehicles, including around three quarters of all SFO cases.

19. There are some current legal means of defining and holding accountable those who control a company's directors. These persons and their behaviour may currently be covered by provisions such as those relating to shadow directors or offences in statute and common law such as those which seek to capture persons who encourage or facilitate the commission of an offence (for instance by a director).

20. In current company law, a shadow director is defined as a person 'in accordance with whose directions or instructions the directors of a company are accustomed to act.' The general duties owed by directors in the 2006 Act apply to shadow directors where, and to the extent that, the corresponding common law rules or equitable principles apply. This means that shadow directors have different, and perhaps less accessible or robust, duties relative to those of directors (whom they might control).

21. Being a shadow director is neutral in and of itself. In most circumstances, it will neither matter nor be widely known that a person meets the definition of a shadow director. The current definition and legal framework simply means that in company and insolvency law a shadow director can be responsible, when things go wrong, in some of the same ways as appointed directors would be.

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126 Guardian and Panorama in particular.
127 http://www.theguardian.com/uk/2012/nov/25/offshore-secrets-revealed-shadowy-side
128 http://www.globalwitness.org/sites/default/files/library/Grave%20Secrecy%20briefing%20document.pdf
129 Company population estimates were extracted from the FAME database (Bureau van Dijk Electronic Publishing, 2013) on 13 December 2013

Whether or not a person is a shadow director is determined, alongside any wrongdoing, by the courts.

22. Controlling a single director, perhaps even causing their misconduct or disqualification, is not currently sufficient to be defined as a shadow director. Therefore, persons exercising control of a single director can sometimes avoid accountability.

23. There is no means of identifying how many directors might be influenced by a shadow director in the UK at the moment under either the current or an updated framework. Due to the nature of court reporting, there is also no means of identifying how many cases have involved shadow directors in the UK over recent years – though there have been some high profile cases. The Insolvency Service will also sometimes disqualify shadow directors, as they would disqualify an appointed director (as a small proportion of their total disqualifications of around 1200 per annum).

24. In the overall context of the UK economy, these estimates clearly represent a subset of companies and better practice is likely prevalent more widely. But they are not insignificant, and there is clearly scope for driving down illicit activity in the UK system. At the same time all companies could benefit from the promotion of good practice and support for the business environment in the UK.

Annex E – A central scenario for exceptions from the prohibition of corporate directors as described in option 2 (preferred option)

1. As set out in the main body of the text, exceptions from the prohibition of use of a corporate director 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 regulation 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.

2. When these exceptions are formalised in regulations, we will undertake further analysis with respect to that step. For the purposes of the present IA, we have set out the relative costs and benefits of some illustrative scenarios for exceptions. These scenarios are drawn from views we heard during consultation.

3. To explain these illustrative scenarios further :

- Listed companies on an EU regulated market in large group structures

Listed companies are already subject to a high level of disclosure which make them relatively low risk in terms of illicit activity facilitated by opaque 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)[130]. 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 many companies in the group.

- Large private companies in group structures

Large private companies 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 might 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 also likely to derive particular benefit from corporate directors and their professional expertise, since they might suffer particular barriers to engaging individuals.

- Pension funds

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, any companies involved with pension funds are likely to be part of a system of regulationed and to derive benefit from corporate directors, whose professional expertise could be more easily engaged (relative to engaging an individual).

130 www.londonstockexchange.com/companies-and-advisors/main-market/documents/brochures/admission-and-disclosure-standards.pdf

Annex F – A theoretical and empirical framework linking trust, transparency and growth

11. 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[131]. 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)[132] 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[133] were five times higher for the least trusted supplier.

12. There is also a known link between overall economic growth and trust,[134] with the literature commonly identifying a significant positive relationship between the two. This emerges because trust motivates investment, innovation and more broadly entrepreneurship[135]. 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)[136] 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)[137] 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.

13. 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)[138] 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),[139] 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.

14. Analysis of U.S. states by Dincer and Uslaner (2010)[140] 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

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131 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.
132 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
133 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.
134 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 .
135 However, the literature must carefully control for reverse causality, i.e. how far high growth countries are generally more trusting.
136 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
137 Zak, P.J. and Knack *(2001)'Trust and growth'* S Economic Journal, 111, 295–321.
138 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
139 Horváth, R. (2013) *Does trust promote growth?* (2013) Journal of Comparative Economics, Elsevier, vol. 41(3), pages 777-788.
140 Dincer and Uslaner (2010) *'Trust and Growth' Public Choice*

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).

15. 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)[141] 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.

16. 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 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.

17. Two notable exceptions are Bjørnskov (2012)[142] and Botazzi et al (2010)[143], 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)[144], 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.

18. Indeed, during discussions with business at a series of focus groups, they largely validated this view:

> *'If a company knew who was behind the company they were making a deal with, it could save them from making bad decisions'*

Moreover, one business commented that *Transparency and Trust* might encourage Foreign Direct Investment, if the package makes it easier for overseas companies to see who they are dealing with.

19. 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)[145] 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.

20. By increasing corporate transparency, including through reducing the use of opaque arrangements involving company directors, benefits to trust, and therefore the business environment and potentially economic growth, should be realised.

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141 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
142 Bjørnskov (2012) '*How Does Social Trust Affect Economic Growth?*' Southern Economic Journal, Working Paper 06-2
143 Botazzi, L., Da Rin, M. and Hellman, T. (2010) '*The importance of trust for investment'* NBER Working Papers 16923
144 Guiso, L, Sapienza, P. and Zingales, L. (2008) '*Trusting the Stock Market'* The Journal of Finance, Vol 63, Issue 6, pp2557-2600
145 Whiteley, P. (2000). *Economic Growth and Social Capital* Political Studies 48, 443-466.

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