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Submitted by email to: transparencyandtrust@bis.gsi.gov.uk

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Dear Sir/ Madam

ICSA response to BIS Transparency and Trust discussion paper

Thank you for giving ICSA the opportunity to comment on the above discussion paper. As you will be aware, the Institute of Chartered Secretaries and Administrators (ICSA) is the professional body that qualifies Chartered Secretaries and central to our members' role is good governance which incorporates Transparency and Trust in UK companies.

We have formulated this response with a working group of company secretaries, including members of the ICSA Company Secretaries Forum. However, the views expressed in this response are not necessarily those of any individual members of the ICSA Company Secretaries Forum or the companies they represent.

a) General points

The intentions behind the discussion paper are to be commended and we appreciate the desire to increase transparency and trust in UK companies. We have a few general observations and some detailed comments on specific areas.

Reforms which seek to enhance transparency in order to help tackle tax evasion, money laundering and terrorist financing, and to ensure that investors, employees and consumers have trust in UK companies in order to encourage investment and growth in the UK are to be applauded. However commendable the intentions are, careful consideration needs to be given to the proportionality of the reforms, how they will be implemented, how unintended consequences will be dealt with and the length of transitional periods. As highlighted in the foreword of the paper '*the overwhelming majority of UK companies contribute productively to the UK economy, abide by the law and make an enormous contribution to society*'. The challenge is to avoid increasing the compliance and resource burden for all companies disproportionately, in order to prevent a minority from breaking the rules. Changes need to be proportionate and considered.

b) Specific comments

A. Enhancing Transparency of UK company ownership Qus. 1-26

1. Beneficial ownership and a central registry

The proposed definition of beneficial ownership and its application in respect of information to be held by a central registry is acceptable on first reading. Careful consideration needs to be given to the following:

1.1. Threshold of beneficial ownership disclosures at 25% is manageable and reasonable for companies of all sizes to comply with. Requests to reduce this to lower thresholds should be avoided.

1.2. It would seem reasonable to include LLPs as well as private and public companies.

1.3. All share types should be included ordinary, preference etc.

1.4. Avoid duplication of existing requirements – i.e. FCA transparency and disclosure rules require ownership notifications to be disclosed. Cross reference to these should be made at Companies House and requests for duplicate information should be avoided. Consideration in this respect should also be given to AIM listed companies who provide similar notifications under the AIM rules.

1.5. For those companies not exempt from establishing beneficial ownership through FCA or similar disclosures a simple and balanced system needs to be put in place.

1.6. Responsibility and obligation for the establishing of beneficial ownership details needs to be balanced and proportionate between companies and investors. It would appear sensible to extend Part 22 of the Companies Acts 2006 ("CA06") and give all companies the legal power to ask investors for details of beneficial ownership and for there to be a requirement on investors to respond to such requests together with appropriate penalties for non-compliance. Similarly it is acceptable to require investors with shareholdings over 25% or those with less but acting in concert with other parties taking the total holding over 25%, to notify companies of this interest for onward disclosure to the central registry. The legislation needs to clarify what the company, director/shareholder is obliged to disclose. Currently, companies are only required to publish what they are advised by directors (in relation to share interests in the directors report and share dealings under the DTR).

1.7. However, in our view it is not reasonable, and far from proportionate, to place a requirement or obligation on companies to obtain this information and hold them to account if they are not successful in doing so because the investor ignores the request or is evasive – this would set a dangerous and impractical precedent. Likewise, it is not reasonable to require a company to know when investors holding below the 25% are acting in concert with other investors. Companies may suspect this is the case and perhaps ask for confirmation (positively or negatively) but they cannot be deemed to know this information. In such circumstances, responsibility needs to be placed fully with investors. We support the suggestion in the discussion paper that investors be required to declare interests over 3%, including multiple holdings; however the requirement on the company should only be to declare beneficial holdings over 25% and not below this threshold, as the administrative burden would outweigh the benefits.

1.8. It might be possible that suspicions as to connected part holdings could be investigated and recorded with a director declaration made on the annual return that reasonable endeavours had been made to establish the beneficial owner. A list of names of beneficial owners could be added alongside the registered owners for those holdings over 25%. However, our view would be that this would create a disproportionate burden on companies

1.9. There are arguments for and against recording the beneficial ownership on annual returns. The main one being that it is out of date until the next annual return and it is possible that the information at the time of the annual return could be manipulated by those persons intent on avoiding detection. But we suspect that this will be a minority of cases and where suspicions are held by law enforcement agencies and law authorities of such malpractice then they can investigate. For the majority of smaller companies this would be the simplest method of recording and as stated in the consultation 98% of companies currently comply with this system. It adds a process to an existing administrative procedure and would not be difficult to 'educate' companies to complete, nor would they be worried when to make a return or how. For many smaller companies holders of 25%+ beneficial shareholding will not change often. Large companies will already be providing notifications under FCA or AIM Rules as and when they occur (and annually in the report and accounts), and so mid-year changes could be considered, but it is probably more administratively efficient to operate a three yearly reporting cycle with changes made annually as for registered holders. The process may be slightly more onerous for large private companies or PLCs not listed on a regulated market, but even with these companies it is unlikely that holders of 25%+ shares will change often. Provided there are safeguards for companies regarding investors acting in concert without their knowledge, we do not envisage such reporting to be overly onerous. This is provided the notification threshold remains at 25%+ and is not reduced below this level. With regards to proposed changes for the future of the annual return, on initial reading it would appear reasonable to simplify filing requirements for companies whilst ensuring the register remains up to date. The proposal to combine the filing of the annual return and the accounts would appear to be sensible, and we await further details in the autumn consultation in order to decide whether a more considered response is required.

1.10. With regards to making the information publically available, whilst this might appear the most beneficial solution both for the public and achieving the government's aims of not only ensuring transparency but also accuracy through public scrutiny, we believe that there are concerns which override this. If the register were to be open to public access then shareholders would then be exposed to the risk of fraudulent actions such as boiler-room scams. Concern has also been expressed by some companies where their beneficial owners are high profile and open to undesirable reputational exposure should their holdings be disclosed publically. Such companies have no qualms with obtaining and disclosing the information to restricted governmental, taxation or enforcement authorities – something similar to returns made under the Patriot Act in the United States – but not for wider public consumption. Other candidates requiring legitimate exemption might be minors' trusts and prominent family groups.

1.11. We await the detailed consultation in the autumn with regards to the policy change on the location of a private company's register of members. Careful consideration would need to be given as to what information was held at Companies House and whether there were legitimate reasons for exemptions. Although the intention is to avoid duplication; most companies will hold the information at the registered office and extract what they need for an annual return. There is a possibility that a dual system – one applying to small companies with a stable shareholder base and another for those with frequent changes – would add more confusion, cost and lead to unintended consequences. Another unintended consequence would be companies having to unwind any SAIL address arrangements for their register of members but keep it for other registers, increasing confusion and workload. There is a danger that if the register was kept at Companies House, it would be relied upon as up to date when the Company Secretary might be aware of a transfer that was awaiting an impending adjudication at the stamp office.

2. Abolition of Bearer Shares

2.1. Although we appreciate there are legitimate reasons for using bearer shares the companies that do are in the minority and the risk of abuse outweighs the reasons for keeping them. Careful consideration would need to be given to transitional arrangements and periods for conversion for those companies who do currently use bearer shares.

3. Nominee directors

3.1. The removal or restriction of the use of nominee directors is a concern for some companies, as with corporate directors (below), within a group structure arrangement.

3.2. Careful distinction needs to be made between different types of nominee directors: a) those that are paid nominees who merely rubber-stamp another parties' decisions and seek to legally divest themselves of the power to run the company; and b) those that are legitimately representing a shareholder or parent company.

3.3. Consideration needs to be given for the latter legitimate use by groups of companies (public and private) and a carve-out considered. One consequence of removing nominee directors would be to have ultimate parent company directors on the boards of all subsidiaries (which can run into 1000's), an excessive administrative and resource burden placed on all companies in order to stop a minority who abuse the system. Another legitimate use of nominee directors is in joint venture arrangements.

3.4. Those that should be targeted are the paid nominees who are abdicating their directors' duties and responsibilities. If there are circumstances where such directors' duties can be abdicated in this way, then there is an argument to remove this loop-hole and strengthen the Companies Act 2006 requirements. The proposal to more widely communicate the application of directors' statutory duties and to require nominee directors to disclose the nominee status and upon whose behalf they have been appointed, would appear reasonable. There may be valid requests (i.e. from high profile or vulnerable clients) for non-public disclosure of the beneficial owner but there could still be private disclosure.

3.5. Disclosure of the use of a nominee status would be particularly useful where a paid nominee director (the 'natural person') is combined with a corporate director in order to hide the true owner and controller of companies. Where such arrangements exist in legitimate group structures, disclosure and evidence that the nominee director (and most likely the individual directors of the corporate director) is also an employee of the parent company or underlying beneficial owner would assist in proving the legitimacy of the process. This combined with closing of loop-holes allowing directors to divest responsibility and or face disqualification, should help eradicate the problem without increasing the compliance burden for the majority of companies.

3.6. A minor aside is in 4.19 the assumed hourly rate of £11.50 and £22.73 for company secretaries and legal professionals would appear unusually low, which will impact on the costs listed therein.

4. Corporate Directors

Removal of corporate directors is a concern for many companies of all sizes as these provide a legitimate administrative function. A carve out for group structures (both PLC and private) should be considered. The increase in administrative resource burden for companies of all sizes that use corporate directors far out-weighs the minority of companies that abuse them. This is a legitimate administrative function used by many companies and although the number of corporate directorships may be small in comparison to the number of companies registered, these are often used on several hundreds of subsidiary companies within a group. So, for example, if a corporate director has 6 senior employees as its directors, and this corporate director is registered as a director on 500 companies, a single change in personnel requires only 2 forms to be completed (one resignation and one new appointment on the corporate director company), compared to 1,000 forms (one appointment and one resignation for each subsidiary) if individuals were to be appointed personally on all 500 companies. We appreciate that an alternative arrangement is for companies to arrange for certain individuals to have authority to execute for a subsidiary, and if there was a choice to be made between abolishing nominee or corporate directors, then some of our members would opt for the former. However, the preference would be to keep both nominee and corporate directors and make the law work correctly rather than abolish a well used mechanism used by many to stop a minority.

4.1. Another area where a carve-out may be required for legitimate use of corporate directors is those freelance company secretaries who act as incorporation agents and for ease of administration use corporate directors.

4.2. All companies need to have one ‘human’ director thus there is always one named individual in which to target enquiries and, as mentioned above, if this is a nominee director, declarations to this fact and disclosure of the underlying beneficial owner or on whose behalf they act would help remove this loop-hole. Where there is legitimate use by companies of corporate directors, it is usually apparent, as generally:

4.2.1. They are used for signatory purposes to avoid multiple appointment and resignation letters when personnel change (as illustrated above);

4.2.2. They are serviced by individuals not a series of other corporate directors; and

4.2.3. They are generally employees of the group.

Instead of abolishing the use of corporate directors altogether, alternatives should be considered such as a requirement that where corporate directors are being used there should be 2 natural persons only one of which can be a ‘nominee’ or one natural person who cannot divest themselves of their responsibilities and that the corporate director has some if not all natural persons as its directors not more corporate directors. The aim being that there is not several layers of corporate directors and nominees owning subsidiary companies within the group.

B. <u>Increasing trust in UK Business Qus 27-72</u>

5. Clarifying the responsibilities of directors

5.1. We can understand the intentions behind the proposal to strengthen responsibilities of banking directors by amending directors’ duties in the CA06 to create a primary duty to promote financial stability over the interests of shareholders, especially in light of the government's commitments to other banking regulation reforms. However, the introduction to CA06 of sector specific regulation, rather than size, establishes a precedent which could lead to requests for other similar amendments. This in turn could result in creating company legislation which is confusing, complex and contradicts original intentions behind CA06 reforms. It also runs counter to the ethos of CA06 which was aimed at making legislation easier for smaller companies and take a "think small first" approach adding extra requirements for larger companies, rather than vice versa, as the CA85 had done. An alternative approach is to cover this responsibility through the approved persons regime, not the CA2006. It also overlooks the fact that directors already have a duty to the company under CA06 to promote its long-term success. If directors have been focusing on short-term rewards then perhaps they need to be reminded of their existing duties rather than adding new ones via the CA06. It is also not clear how shareholders of such banks would react if their interests are subordinate under CA06 to the stability of the firm. Furthermore, not all banks are caught by the CA06. Thus such a change to UK legislation means that UK banking directors would be operating under more onerous directors' duties. There is also the question of whether the definition of banking sector would in time be extended to 'other financial institutions' and how these would be defined. We would agree with the comment made in the paper that "sector-specific issues are best dealt with through a sector-specific regulatory regime, which operates in addition to a general company law regime". We think that the perhaps the other proposals in the document might be better at achieving behavioural change.

6. Allowing sectoral regulators to disqualify

   6.1. Where directors have been barred or prohibited from senior positions in key sectors there could be an argument that they should be considered for disqualification from acting as a director of any CA06 company. However, this should probably be a referral from the sectoral regulators such as the FCA to a Court or ombudsman, rather than extending powers of such sectoral regulators to decide this directly. The ability to refer could be extended to FCA, The Pensions Regulator and PRA as suggested in the paper. It has also been suggested that findings of other regulators should be used in proceedings again directors rather than repeating investigations or missing possibly missing significant input to proceedings.

7. Factors to be taken into account

   7.1. The proposals under this section to allow amendments to Schedule 1 to the CDDA to include other 'factors' to be considered in disqualification proceedings appear to be sensible on first reading. Care would need to be taken with regards to definitions and levels of discretion to be given to courts to ensure that decisions reached are fair and proportionate.

8. Compensatory awards against directors

   8.1. Although attractive in theory as a method of improving confidence in the insolvency regime, the practicalities and cost involved are possibly prohibitive.

9. Time limit for disqualification for proceedings

   9.1. The proposal to increase the time limit from 2 to 5 years (or somewhere in between this period but not longer) would appear to be sensible in order to protect the public and address concerns of creditors whilst ensuring that proceedings are brought promptly.

10. Educating directors

10.1. We would strongly support the proposal to educate directors. Such education could perhaps lead to a reduced period of disqualification or be a pre-condition for any disqualified director wishing to seek leave of the court to run a company whilst disqualified.

10.2. We would also suggest that much could be done on setting up a company either via the government's gateway or Companies House websites, simply by placing very prominent notices that applicants seek professional advice, such as from company secretaries. Directors would then be fully informed as to their duties, responsibilities, statutory filings, records and governance procedures which would facilitate their business and guard against failure as well as ensure compliance and increase trust in UK companies. If they use a company secretary upon incorporation, as we would encourage, this training and advice could be given as part of the incorporation package.

10.3. It has been evidenced in other fields that the best deterrent is the likelihood of being caught, some commentators have therefore suggested that resources be used ensure this likelihood is increased – thus making more directors self educate at start-up stage rather than at disqualification.

11. Extending overseas restrictions

11.1. It would appear sensible to consider using the powers in Part 40 of CA06 to prevent persons who are subject to foreign restrictions being able to be directors or act in the management of companies in the UK. Although this should probably require the Secretary of State to make an application to a court rather than be automatic. Should the above power not be exercised a reasonable alternative would be to oblige a person subject to foreign restrictions to notify the Registrar of Companies, if they act in the promotion, formation or management of a company in the UK. We think it could be difficult for courts to make disqualification orders based on criminal offences overseas in connection with the management of a company overseas. However, there could be circumstances where it would be in the public interest for the Secretary of State to have the power to bring such proceedings. As with all of the above proposals, consideration should be given as to possible unintended consequences and their impact on the UK as a business centre.

12. Other comments/ observations

12.1. One final point we would like to make is an issue that has been raised in previous communications with BIS, HMT and Companies House in 2011. This is the anomaly which has previously come to light with the introduction of web incorporation by Companies House, a policy focused on 'delivering electronic governmental services and encouraging entrepreneurship'. Here, the interpretation and implementation of EU directives and AML so that it is not considered applicable to Companies House are having the counter-productive effect and risk of creating greater levels of fraud, terrorist activity and consequential costs.

Either:

i. Money laundering and terrorist financing <u>is a key prevalent risk</u>, in which case AML regulation should apply <u>equally to public and private bodies</u> where they are exposed to that risk; or
ii. If company formation and related services (provided by company secretaries amongst others) is a low risk industry <u>then both private and public organisations</u>

providing such services should not have to comply with, and be supervised for, AML regulations.

The second review of the Financial Action Task Forces ("FATF") global standards on money laundering and terrorist financing issued in June 2011 highlights the fact that there is growing AML concern regarding the use of companies, which makes the Companies House "light touch" web incorporation inappropriate.[1] This illustrates a conflict between the government's desire to 'cut red tape' and encourage entrepreneurialism for smaller enterprises, whilst trying to ensure transparency and trust in UK companies. If there is a real threat from, and desire to, defeat 'tax evasion, money laundering and terrorist financing' then a review of AML procedures via web incorporation at Companies House is necessary.

Finally, we see one of the major benefits for companies of the proposals in this discussion document being the potential for a reduction in the degree to which companies have to go through a full AML procedure every time they deal with a professional advisor. It would be a significant reduction in overall red-tape if they were able to rely on a slightly enhanced process at a Bank or at Companies House and then point to that 'registration' on any future engagement.

13. Conclusion

13.1. In conclusion, the proposals are sensible and the aim and intention admirable, provided balanced and carefully considered. Increased transparency is good and as the paper highlights trust in UK companies is necessary, especially in light of recent corporate failings. The proposals to increase this trust appear to be reasonable, again provided they are proportionate and do not penalise the majority in order to prevent a few.

We hope you find our comments helpful and if you would like to discuss any of the points in more detail, please let me know.

Yours sincerely

Seamus Gille

Seamus Gillen FCIS
Policy Director

[1] (See pages 5-6 relating to *Recommendation 33* of the consultation found at: http://www.fatfgafi.org/dataoecd/27/49/48264473.pdf).