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City of London Law Society Company Law Committee response to the Department for Business, Innovation and Skills Consultation Paper on *Corporate Directors: Scope of exceptions to the prohibition of corporate directors*

The City of London Law Society ("CLLS") represents approximately 15,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees. This response in respect of the Consultation Paper on **Corporate Directors: Scope of exceptions to the prohibition of corporate directors** has been prepared by the CLLS Company Law Committee.

Introduction

To put our responses to the questions you have asked in context, we would note that the Consultation Paper justifies the ban on corporate directors on two grounds (in paragraph 4) –

- corporate directors might introduce sub-optimal behaviour and sub-standard corporate governance in companies, and
- corporate directors might reduce the sense and effect of accountability of individuals, who ultimately take the decisions.

You note (paragraph 6) that you want to increase trust in business by increasing corporate transparency and reduce the potential for illicit activity. You also wish to be pragmatic and proportionate.

In paragraph 17 you say that the key consideration for an exception to the prohibition of corporate directors is those factors which might or might not render a group structure transparent or well governed.

We welcome the proposed exceptions for groups of companies, which we think will facilitate business efficiency without compromising your objectives. In the context of a

group of companies, with a disclosed parent company exercising control over the whole group, the principal focus for governance and transparency should be on the parent. Absent insolvency or the risk of insolvency, the board of the parent will have ultimate accountability for the conduct of the group it controls. The transparency objective is therefore met by the existing requirements for disclosure by a company that is a subsidiary undertaking of its parent undertaking and ultimate parent company – see the Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2008, Schedule 4, paragraphs 8 and 9 (the "2008 Regulations").

If the parent undertaking or ultimate parent company is a UK incorporated company, the disclosure requirements of the 2008 Regulations should provide sufficient transparency. Further assurance of transparency would be achieved if the parent had only natural persons as its directors.

If the parent undertaking or ultimate parent company is incorporated outside the UK, we suggest that, in principle, the objectives are met if (a) that company is subject to substantially similar transparency obligations to those applicable to a UK company and (b) its directors are all natural persons.

Our responses to the questions below include this approach and give further detail. We also believe that where a company is listed, that company and UK companies in its group should benefit from an exemption.

UK companies with shares admitted to trading on regulated markets

1. **Should we use UK companies listing on UK regulated markets as a basis for an exception from the prohibition of corporate directors? And UK subsidiaries of non-UK companies listed on UK regulated markets?**

   UK and non-UK companies listed on a regulated market are subject to the Vote Holder and Issuer Notification Rules in DTR5 and for that reason will be exempt from the obligation to provide information for the register of People with Significant Control. The ownership and control of such companies will be transparent. We would, however, suggest an additional requirement, that the directors of the listed company on which the exemption is based must all be natural persons.

2. **Should we use listing on other markets, with broadly similar rules to those of UK regulated markets, as the basis for an equivalent exception from the prohibition of corporate directors? Do you have any further thoughts on the handling of UK companies listed on overseas markets, and evaluation of their rules and requirements?**

   A company with a listing on an overseas market which is subject to rules (on disclosure of ownership and control) that achieve a broadly similar outcome to those subject to the UK rules should, we believe, be treated similarly. We would, however, also impose the additional requirement, that the directors of the listed company on which the exemption is based must all be natural persons.

   We assume the test of whether rules are “broadly similar” is the same as will apply to the PSC register requirements. In that connection we have previously

noted that DTR 5.11.6R contains an exemption for non-EEA companies "whose laws have been considered equivalent for the purposes of article 23 of the TD". We again suggest that be used as the starting point for which systems of rules should be regarded as "broadly similar".

Note that the Financial Conduct Authority has stated that it is satisfied that the laws governing disclosure of major shareholders in the USA, Japan, Israel and Switzerland are equivalent to DTR5, so that companies incorporated in any of those countries with securities admitted to trading on a UK regulated market are exempt from DTR5 (see http://www.fca.org.uk/firms/markets/ukla/information-for-issuers/non-eea-regimes). It would be helpful for there to be a statement about the way in which a decision could be taken that the laws of other jurisdictions are considered equivalent – and whether this will be done by the FCA (even if the relevant company's shares are not listed in the UK).

3. How far should an exception extend in the group?

a. Should it apply only to dormant companies?

We do not see the justification for restricting the exception to dormant companies. Dormant companies are not the only companies in a group structure that may benefit from the use of corporate directors and we do not see any good reason to limit the exception in that way.

Should it apply to

b. wholly owned subsidiaries; or

c. subsidiary bodies corporate controlled through voting rights or control of directors; or

d. subsidiary undertakings subject to wider means of parental company influence?

We believe the exemption should apply to subsidiary undertakings, the widest possible definition proposed here. The important point is that the person exercising control, the parent company, is the entity which satisfies the tests of transparency and good governance. That degree of control and transparency at the head of the group should be sufficient assurance that the use of corporate directors will not be abused.

4. Should it apply only to companies appointing another company in the group or a parent company only? Should this be made explicit?

While a corporate director may often be a group company, we do not believe that will invariably be the case. We reiterate our point above that the identity of the corporate director is less important than the transparency and governance of the person appointing the director and in overall control of the entity to which the corporate director is appointed. If the parent company is listed on a regulated market, and so subject to requirements of transparency and good governance,

the exemption should allow any companies which that listed company controls to appoint any person as a corporate director.

5. **Should it apply only to companies appointing a corporate director whose directors are all natural persons?**

   Similarly, we see no justification for a further restriction requiring the directors of a corporate director to be natural persons. Any company will be required (as at present) to have at least one natural person as a director, and we see no benefit from complicating the exemptions with additional requirements for which there is no justification. (See, however, our response to Question 22 where we suggest an exception to that principle might be justified.)

6. **Are there any other arrangements or relationships we should consider?**

   We have not identified any other arrangements or relationships where an exemption would be useful.

7. **Can you provide any evidence of the costs and benefits of your preferred outcome?**

   The benefits of using corporate directors have been stated previously by several respondents to previous consultations. We do not see any disadvantages to exempting such regulated groups.

UK companies with shares admitted to trading on prescribed markets

8. **Should we use UK companies listing on UK prescribed markets as a basis for an exception from the prohibition of corporate directors? And UK subsidiaries of non-UK companies listed on UK prescribed markets?**

   We would agree with your assessment that the same arguments in respect of companies listed on regulated markets apply to those listed on prescribed markets and, in respect of this and the subsequent questions 9 to 14, would echo our responses to questions 1 to 7 above. We see no reason to differentiate between companies listed on regulated markets and those listed on prescribed markets.

   Note that UK incorporated companies with shares traded on AIM are subject to DTR5. Where an AIM company is incorporated in a jurisdiction which does not have a similar shareholder disclosure regime to DTR5, the guidance to AIM Rule 17 requires the company to use all reasonable endeavours to take measures to require significant shareholders to notify the company of relevant changes in their shareholding, and they are advised by that guidance to achieve this by incorporating disclosure provisions in the company's constitution in similar terms to DTR5. We believe that companies that have incorporated such provisions should be entitled to an exception.

9. **Do you have any further comments on overseas markets broadly similar to UK prescribed markets which are not covered above (in your response to question two regarding overseas markets broadly similar to UK regulated markets)?**

10. **How far should an exception extend in the group?**

    a. Should it apply only to dormant companies?

    Should it apply to

    b. wholly owned subsidiaries; or

    c. subsidiary bodies corporate controlled through voting rights or control of directors; or

    d. subsidiary undertakings subject to wider means of parental company influence?

11. **Should it apply only to companies appointing another company in the group or a parent company only? Should this be made explicit?**

12. **Should it apply only to companies appointing a corporate director whose directors are all natural persons?**

13. **Are there any other arrangements or relationships we should consider?**

14. **Can you provide any evidence of the costs and benefits of your preferred outcome?**

Public companies without shares admitted to trading

15. **Should we use public company status as a basis for an exception from the prohibition of corporate directors?**

    See our response to question 16 below.

16. **Should any exception extend to all public companies, only to large public companies, or only to large public companies in group structures?**

    For the reason given above we think the additional emphasis on good governance that exists in relation to companies whose shares are publicly traded is very much a secondary consideration compared to the transparency of ownership and control of the parent. Accordingly, we think that groups headed by large non-listed public companies subject to the 2008 Regulations should be eligible for the exemption in the same way. If the parent is a UK company it will be subject to the PSC regime, which provides the required transparency of ownership and control. A requirement to have only natural persons as directors will give further assurance on transparency.

If the parent is a non-UK company and can establish that it is subject to or observes a standard of transparency of ownership and control broadly similar to the 2008 Regulations and the PSC regime, and has only natural persons as directors, its group companies should benefit from the exception. In this context, it would be helpful if, in due course, you were to publish a list of overseas jurisdictions which you regard as having such broadly similar disclosure regimes.

17. How far should an exception extend in the group?

a. Should it apply only to dormant companies?

Once the exception is granted, we believe that it should be applied throughout the group. We therefore respond to questions 17 to 21 as we have to questions 1 to 7.

Should it apply to

b. wholly owned subsidiaries; or

c. subsidiary bodies corporate controlled through voting rights or control of directors; or

d. subsidiary undertakings subject to wider means of parental company influence?

18. Should it apply only to companies appointing another company in the group or a parent company only? Should this be made explicit?

19. Should it apply only to companies appointing a corporate director whose directors are all natural persons?

20. Are there any other arrangements or relationships we should consider?

21. Can you provide any evidence of the costs and benefits of your preferred outcome?

Private companies

22. Should we use large private company status as a basis for an exception from the prohibition of corporate directors?

We would make the same point in respect of private companies which qualify as "large" for accounting purposes under the 2008 Regulations as is made above in respect of large public companies for the reasons given in response to question 16 above. For these purposes, we see no material difference between large public and large private companies. We therefore reply to questions 22 to 28 in the same terms as we have replied to questions 16 to 21.

In the case of a group of companies headed by a private company which is not subject to the 2008 Regulations (but which is subject to the PSC regime), you might consider extending the exemption to the subsidiaries and subsidiary

undertakings of the parent, provided that (a) the ultimate parent only has natural persons as directors, and (b) the directors of any corporate director of a subsidiary or subsidiary undertaking are themselves all natural persons. This latter requirement can be seen as giving the assurance of transparency which is not given in this case by the 2008 Regulations.

23. Should any exception extend to all large private companies, or only to large private companies in group structures?

24. How far should an exception extend in the group?

a. Should it apply only to dormant companies?

Should it apply to

b. wholly owned subsidiaries; or

c. subsidiary bodies corporate controlled through voting rights or control of directors; or

d. subsidiary undertakings subject to wider means of parental company influence?

25. Should it apply only to companies appointing another company in the group or a parent company only? Should this be made explicit?

26. Should it apply only to companies appointing a corporate director whose directors are all natural persons?

27. Are there any other arrangements or relationships we should consider?

28. Can you provide any evidence of the costs and benefits of your preferred outcome?

Companies in regulated sectors

29. Are there any further areas where regulation supports high standards of transparency and corporate governance, which might also suggest a basis for an exception?

We believe that the arguments made above in relation to questions 1 to 7 for listed companies apply equally to companies which are regulated by the Financial Conduct Authority or the Prudential Regulation Authority. Those companies are subject to significant regulatory checks and continuing oversight. The control of such companies is checked and known and the regulators seek to ensure that various elements of good corporate governance are complied with.

There may not be many FCA or PRA authorised entities which have a corporate director (and if they do, that corporate director would itself need to be approved for that role) but we believe that this exemption from the ban on the use of corporate directors follows logically from the principles set out in the Consultation

Paper. We believe the exemption should apply not only to the regulated entity but should extend also to its subsidiary undertakings for the reason given in response to question 3 above.

Charitable companies

30. Should we use operating as a regulated charitable company as a basis for an exception from the prohibition of corporate directors?

We do not offer a view on questions 30 to 32.

31. How far should an exception extend among charitable companies?

For instance should it apply

a. To all charitable companies; or

b. To charitable companies appointing a charity as corporate director; and/or

c. To charities appointing a public body as a corporate director; and/or

d. To charities of a certain size; and/or

e. On the basis of evaluation by charity regulators; and/or

f. On any other basis?

32. Can you provide any evidence of the costs and benefits of your preferred outcome?

Corporate trustees of pension funds

33. Can you provide any further information or evidence we should consider in relation to the abuses or value of corporate directors in the pensions industry?

a. Are corporate directorships in trustees rare, restricted to larger companies and generally transparent? Are there any other or particular arrangements in which they are used in the pensions industry?

Corporate directors are common in the pensions industry. Their use usually arises where a professional independent trustee is appointed as a director of a corporate trustee. As far as we are aware, all of the major professional independent trustee businesses (such as The Law Debenture Pension Trust Corporation plc, Bes Trustees plc, Capital Cranfield Pension Trustees Limited and HR Trustees Limited) do not operate through the appointment of natural persons; they operate instead through the appointment of a company as a trustee or trustee director. Their use is transparent and we are not aware of any abuses resulting from such arrangements. The involvement of independent

trustees with a scheme is generally viewed by the pensions industry as something to be encouraged, as independent trustees offer objectivity, and a wide range of experience and skills. Independent trustee appointments have increased in recent years and not just in relation to large pension schemes. For larger schemes, such appointments are often viewed as part of good governance, providing direction and leadership (the independent trustee director often acts as the chair of the trustee board), helping to fill any skills gaps within the existing trustee board and providing reassurance for members that the scheme is operating with objective oversight. Smaller schemes often struggle to recruit trustees from within the employer's business (whether with suitable knowledge and experience, or at all), and the monetary pressures on smaller schemes often mean that they have more limited professional adviser support than is the case with larger schemes. An experienced professional independent trustee can offer much needed support and cost effective expertise in such cases.

It is worth noting that those working in independent trustee businesses are usually seasoned pension professionals coming from a wide range of backgrounds including pensions actuaries, pensions managers, investment professionals and pension lawyers. A clear advantage for schemes in making a corporate director appointment is the ability to draw on the expertise of different individuals within the independent trustee business where appropriate, as opposed to appointing one particular individual originating from just one of these backgrounds. It also allows for changes of personnel without needing to change a director appointment where a pension scheme's usual independent trustee contact changes or is unavailable (and therefore reduces the risk of decisions being taken by an individual who lacked the authority to do so). Where a corporate independent trustee director is used, it also seems to us that checking the coverage of the independent trustee's professional indemnity insurance is likely to be more straightforward (and with less risk of a claim being rejected on the basis of actions having been taken by a different individual).

It is widely recognised in the pensions industry that many professional independent trustee businesses operate through corporate director appointments (where the pension scheme has a corporate trustee). For example, the Pensions Regulator maintains its own independent trustee register and accepts applications to be on its register from companies. In fact, the only independent trustee entities on this register as at 5 January 2015 are 15 companies. The Pensions Regulator uses this register to appoint independent trustees to schemes where it wishes to ensure that the pension scheme is being properly administered or that members are protected when the employer sponsoring the pension scheme has become insolvent.

The Government’s current proposals to improve the governance of defined contribution pensions, as set out in the consultation paper ‘Better Workplace Pensions: Putting Savers’ Interests First’, and which are to be implemented from April 2015, accept and endorse the value of professional independent trustee appointments (including appointments of a corporate trustee or trustee firm as an independent director of a corporate pension scheme trustee). For example:

- small self-administered schemes will be exempt from the new governance standards where they have an independent trustee registered on the Pensions Regulator's register (as noted above, currently these are all corporate entities); and

- where a professional trustee firm is appointed as the independent trustee of a master trustee arrangement, the firm itself (as opposed to the individual representing it) will be exempt from the restrictions on maximum term of appointment which will apply to individual independent trustees (although the individual representing the firm would be subject to a restricted maximum term to ensure independence).

b. Are there any significant risks attached to allowing corporate directorships in corporate trustees to continue?

We are not aware of any significant risks attached to the use of corporate directors in corporate trustees and have seen no evidence to suggest such risks exist. There would however be significant risks for the pensions industry if company director appointments were to be prohibited in the context of a corporate pension scheme trustee. Such approach would risk the loss of independent trustee expertise (we do not know if those offering their expertise through a corporate appointment would be willing to do so through appointment as natural persons), as well as reducing a pension scheme's ability to flexibly access and draw upon different skill-sets available within an independent trustee's business.

34. Is there more that should be done to improve transparency of corporate directorships in corporate trustees?

No. We are not, in any event, aware of any issues arising from a lack of transparency of corporate directorships in corporate trustees.

35. Can you provide any evidence of the costs and benefits of your preferred outcome?

The disadvantage of prohibiting the use of corporate directors will be the potential loss of access to the knowledge, skills and objective oversight offered by professional independent trustee businesses. This risks a lower quality of decision making by trustees and ultimately worse outcomes for pension scheme members. Reduced professional independent trustee involvement in pension schemes would be a reversal of the direction of travel evident in the pension schemes' industry over the last few years, and which we believe has been viewed as a positive direction of travel by the pensions industry, the Department for Work and Pensions and the Pensions Regulator.

Societas Europaea (SEs)

36. Should we use SE status as a basis for an exception from the prohibition of corporate directors?

Yes. We see no reason to treat SEs differently to PLCs.

Limited Liability Partnerships (LLPs)

37. Do you agree with the approach that use of corporate members of LLPs should continue unchanged in the present reforms?

Yes.

38. Can you provide any further information or evidence we should consider in relation to the abuses or value of corporate members of LLPs?

See the previous submissions on corporate members of LLPs made by the CLLS.

39. Do you agree we should review the issues in relation to corporate members of LLPs in parallel with the review of the Small Business Enterprise and Employment Bill provisions covering corporate directors of companies, or sooner if compelling evidence of abuse of the LLP structure were to emerge?

If compelling evidence of abuse emerges, it would be right to review the use of corporate members of LLPs to curb that abuse.

If you have any questions on this submission please contact Martin Webster (Martin.Webster@pinsentmasons.com).

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