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City of London Law Society Company Law Committee response to the Department for Business Innovation and Skills Discussion Paper on *Transparency & Trust: enhancing the transparency of UK company ownership and increasing trust In UK business*

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 Discussion Paper on **Transparency & Trust: enhancing the transparency of UK company ownership and increasing trust in UK business** has been prepared by the CLLS Company Law Committee.

Introduction

We have seen and generally support the comments made by Law Society of England and Wales in its response (**the Law Society Response**).

In relation to the proposals covered in Part A of the Discussion Paper, we think it is important that any new regime conform to the following principles:

- it should be clear and as simple to apply as is possible; this is essential if the regime is not to result in significant additional costs for companies and their shareholders; this is likely to mean that a simple "copy-out" from the 4th Money Laundering Directive is unlikely to provide the solution. In this case, the adoption of a more detailed regime should not be seen as "gold-plating" but as avoiding the ambiguities inherent in the proposed Directive definition.

- obligations should be imposed on those best placed to fulfil them and should be proportionate to the objective

- UK companies should not be put at a competitive disadvantage and the attractions of the UK as a place to incorporate should not be diminished; we recognise that it may be right for the UK to take the lead internationally and there may be a period during which the playing field is not level but that should be minimised so far as possible.

Part A

Beneficial ownership and a central registry

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

We agree that the 25% level is appropriate. We think the Directive definition is unhelpfully vague, in particular in relation to:

- ownership through companies (it does not deal with the level of ownership that amounts to indirect ownership)

- ownership through trusts.

The regime for determining interests in shares in Part 22 of the Companies Act 2006 is thorough and has been tested over a number of years and we strongly recommend its adoption for the purposes of providing the framework for determining a person's direct and indirect ownership of a company. The one area that will need further work is in relation to "acting in concert". The Discussion Paper refers to the definition in the Takeover Code but we doubt that will be appropriate. The Takeover Code rules on acting in concert spread a very wide net (for example including advisers) and often require thorough investigation and fine judgements to be made. A more precise and more easily applicable definition will be required.

The definition refers to "controlling by other means", which is a particularly wide concept and left in those terms will be very difficult to apply in practice. It would be more efficient and effective if a more precise definition could be adopted.

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

We do not think LLPs should be included for the following reasons:

- members of LLPs are already registered at Companies House with information equivalent to that provided in respect of directors of a limited company (i.e. full information, updated on a real time basis).

- a LLP does not file its Members' Agreement, so the commercial arrangement between the members as to management, voting and economic rights is private. This is a key feature in the attractiveness of LLPs, and was extensively debated at the time that the LLP legislation was enacted with the conclusion being that maintaining privacy was the best way forward.

- a member of a LLP holds management, voting and economic rights, effectively combining the concept of director and shareholder of a limited company. Those rights

need not be held proportionately to one another, and very frequently (much more frequently than for share capital for example) are held on a non-proportionate basis (e.g. voting rights may be "one man one vote", profits may be fixed or merit based or vary according to achievement of hurdles and day to day management may be delegated to a managing partner or managing board). As a result identifying the "beneficial owners" will be much more complex than for a limited company. We also note that a large number of LLPs operate in regulated sectors where the LLP itself and/or all members have been approved by the regulator and in practice therefore the anti-money laundering requirements can be satisfied relatively easily.

- LLPs are, for the vast majority of UK purposes, tax transparent. Therefore, in the context of combating tax evasion, the key is understanding the ownership structure of any corporate members, rather than the LLP itself, as tax is levied at the level of the member. That will be achieved by the proposals applying to limited companies (at least for UK entities). We note that HMRC is also currently consulting on detailed provisions aimed at combating certain potential abuses in the LLP context.

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

We agree that listed or AIM quoted companies that are subject to the regime for disclosure of interests under Chapter 5 of the Disclosure and Transparency Rules should be exempt from the requirement to provide information to the registry.

We suggest there is a case for companies in regulated sectors (e.g. financial services), where "controllers" (or similar) are subject to an approval regime to be exempt.

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

We would agree with extending Part 22 to all companies. We think it will relatively rarely be necessary for private companies to use powers under Part 22 but it would provide a useful mechanism to allow companies to ascertain the identities of their beneficial owners.

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

We do not think it is necessary or appropriate to impose an obligation on the company. The obligation should fall on the person best able to fulfil it, which is the beneficial owner itself. Any obligation imposed on the company will inevitably risk becoming open ended and unduly burdensome.

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

We would support the approach of imposing the obligation on the beneficial owner.

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

We think a regime structured as we have suggested, with clear rules and an obligation placed on the person best able to comply will generally produce reliable information at a cost that should not be excessive. It may not be proof against a determined wrongdoer but we do not think the alternatives are likely to produce a better result.

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

As noted above, we think it will be very important to ensure that the rules are clear and easy to apply. Although the suggested approach is to some extent arbitrary it will be the easiest to apply. It may be appropriate for the trustee to be exempt from the obligation if a beneficiary of the trust is identified to the extent of that beneficiary's notified interest.

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

We think it would be appropriate for a single beneficiary of a trust to be disclosed in the circumstances set out in the discussion paper. Beneficiaries should not be aggregated for this purpose unless they are acting together (in accordance with whatever rules are adopted on parties acting in concert)

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

If additional authorities are to be given these powers the purposes for which they may exercise them should be made clear.

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

We agree with this approach.

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

No comment.

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

We do not think any additional measures are appropriate. We do not agree that the fact that Companies House information is public helps ensure its accuracy.

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

No comment.

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

For almost all companies we would expect beneficial ownership information to change infrequently. If the obligation to notify changes falls on the beneficial owner, we think updating as the information changes is the more straightforward approach.

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

See above. We think this is the right approach.

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

There is no particular urgency for the information to be updated as these companies are not actively traded. We suggest 21 or 28 days might be reasonable.

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

No comment.

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

As a matter of principle, citizens should be entitled to organise their affairs privately unless there is a legitimate public interest that demands that the information be available to the public. We do not think a case has been made out for publicising the information.

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

We do not think regulated entities need a right to access the information. Where a regulated entity is dealing with the company it can and should (as now) request information on beneficial ownership. The effect of the proposed reforms will be to make that information more easily available and more reliable and that should be sufficient.

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

If contrary to the view expressed above the information is made public, it would be essential that appropriate exemptions should be adopted.

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

No comment.

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

See 19 above.

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

Yes.

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

26. In particular:

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

No comment.

Bearer shares

27. Prohibiting the issue of new bearer shares.

While we are not aware of any evidence of bearer shares in UK companies being misused, and so see no direct justification for their prohibition in a UK context, we are also not aware of any specific need to use such shares and acknowledge that their prohibition in the UK may facilitate their prohibition in other jurisdictions where they may be misused.

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

We question whether conversion is of existing bearer shares is justified. It would not appear that there is a major problem and any arrangement for dealing with holders who do not convert (whatever period is set) will be in the nature of an expropriation and in principle undesirable.

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

No comment.

30. The costs and benefits of this policy change.

We are not in a position to estimate the costs but we have not identified any continuing reason for shares to be in bearer form.

Nominee directors

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

A communication exercise would be useful but it would be important to be clear that it was not addressed to the usual relationship between parent company an directors of subsidiaries, which in our experience is not a nominee arrangement. In our view a full abdication of responsibility by a director would be a breach of duty. In that context, requiring disclosure of a true nominee arrangement of the kind described would have the curious result of requiring an admission by the director concerned of a breach of duty.

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

We do not see any need for an offence. If there were to be an offence it would be important that it was not thereby suggested that the arrangement constituting an offence was effective.

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

We have considered whether it would be helpful to extend the "shadow director" provisions as suggested in the Law Society Response. We think that may be an approach worth examining in

more detail but we recognise the force of the "other view" referred to in the Law Society Response.

34. The costs and benefits of this policy change.

No comment.

Corporate directors

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

Corporate directors serve a useful purpose. In addition to the circumstances referred to in the Law Society Response they are used by groups of companies, where having a corporate director facilitates the administration of the companies (eg in relation to executing documents) and avoiding problems that can arise when individual directors cease to be employed by the group.

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

No comment.

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

No comment.

38. The costs and benefits of this policy change.

No comment.

Part B

Clarifying the responsibilities of directors

39. The merits of strengthening responsibilities of banking directors by amending the directors' duties in the CA06 to create a primary duty to promote financial stability over the interests of shareholders..

We strongly oppose this proposal. We think it is unhelpful to confuse regulatory duties (for the benefit of and enforceable by the society as a whole, through effective regulators) with obligations to the company (enforceable by it and its shareholders). Maintaining the distinction is helpful to the decision making by directors, who can be advised on where the regulatory regime sets boundaries for their decisions and within that exercise their judgment on what will promote the success of the company. The objective of any reform of the corporate governance of regulated businesses should be to improve the quality of decision-making by those responsible for the management of the companies concerned. The objective should not be to avoid risk being taken on but to ensure that so far as possible risks are identified and properly balanced against the benefits that can be earned, within the boundaries of risk-taking that is acceptable to society as a whole, set by the regulatory system.

In addition to this fundamental objection the following points can be made:

- if implemented this proposal may affect the ability of companies to raise capital (at the extreme, question their suitability for being listed) by raising questions about the extent to which the objectives of shareholders will be served;

- it is not clear how the "safety and soundness" duty would interact with the requirement to promote the success of the company for shareholders. By expressing this as a primary duty, it may be seen as overriding all decisions; for example, a decision to pay a dividend necessarily weakens the balance sheet of the company and therefore increases the risk to “safety and soundness”;

- those responsible for enforcing fiduciary duties are likely to have little interest in enforcing public interest duties for their own sake;

- it is likely that shareholders in banks will see safety and soundness as an important objective (in furthering the success of the company); the current environment for board/shareholder relationships (the "stewardship" agenda) is different from that operating before the-financial crisis and the Government should wait to see whether that change in approach (and the regulatory changes that have been and are being made) leads to improved decision taking by boards before making a major change to the architecture of directors' fiduciary responsibilities;

- the proposal will be seen as increasing the risk for directors of banks and will reduce further the pool of competent individuals prepared to take on the risks of being a director.

- the regulatory regime is capable of formulating and applying detailed rules applicable to different types of institutions, taking into account their relative importance to the financial system. A “one size fits all” standard is too blunt an instrument to apply to a highly nuanced set of issues.

Allowing sectoral regulators to disqualify

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

The objective of this proposal is not clearly articulated in the Discussion Paper. It appears to be simply to provide regulators with an additional sanction against directors, and one which could have very serious consequences for the individual concerned. There is no evidence from recent experience with the banks that the regulator does not have adequate sanctions. It is asserted by some that directors of failed banks have not been “held to account” but if that is the case it is not for want of effective sanctions. Sectoral regulators are competent to determine whether an individual is fit to play a part in the management of a business within its area of regulation but we question whether such regulators are best placed to determine the fitness of those individuals to act as directors generally.

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

No comment.

42. The potential costs and benefits of this proposal.

No comment.

Factors to be taken into account

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

We would support such a change.

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

As is acknowledged in the Discussion paper social impact is a factor taken into account under the existing regime. Including an express reference gives rise to the problem of definition and runs the risk of thereby limiting the court's discretion to make the right decision in the circumstances of the case.

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

We think it will prove difficult to achieve a satisfactory definition of "wider social impact". In particular, the extent to which non-economic impacts should be taken into account is potentially contentious.

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

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

We see problems of definition of the category of company concerned but if those can be resolved this may provide a useful flexibility.

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

We do not think this is necessary.

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

This would seem effectively to change the burden of proof to the director to show that previous failures were not due to misconduct and we do not think that is justified.

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

To adopt a presumption based solely on a number of failures would lead to arbitrary results and would be unfair.

Improving financial redress

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

No comment.

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

We note the various drawbacks to this proposal identified by the Discussion Paper and do not believe the benefits will be sufficient to justify the proposed change.

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

No comment.

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

No comment.

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

No comment.

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

No comment.

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

It is not clear whether this proposal is intended to broaden the scope of the liability of directors. If the grounds for the compensatory award are the same as those that currently apply, this appears to involve the Secretary of State bringing a case that creditors themselves are not prepared to fund. We wonder whether taking that risk is a good use of taxpayers money.

57. The potential costs and drawbacks of this proposal?

See above.

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

We do not see how the court could decide that a particular creditor should benefit from a claim for breach of duties owed to the company. Any award would have to go to all creditors.

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

Would any such award amount to a settlement of the company's claims against the director? If not the director is in jeopardy of further claims and is unlikely to agree.

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

No comment.

Time limit

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

No comment.

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

No comment.

63. How many directors are likely to be affected?

No comment.

Educating directors

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

No comment.

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

No comment.

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

No comment.

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

No comment.

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

No comment.

Overseas restrictions

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

We agree that it should be possible to disqualify individuals who are disqualified in other jurisdictions.

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

There should be an application to the court to ensure that the foreign disqualification is based on considerations that would be relevant in the UK.

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

Yes.

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

Yes.

If you have any questions on this submission please contact William Underhill (william.underhill@slaughterandmay.com; 0207 090 3060).

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