The City of London Law Society

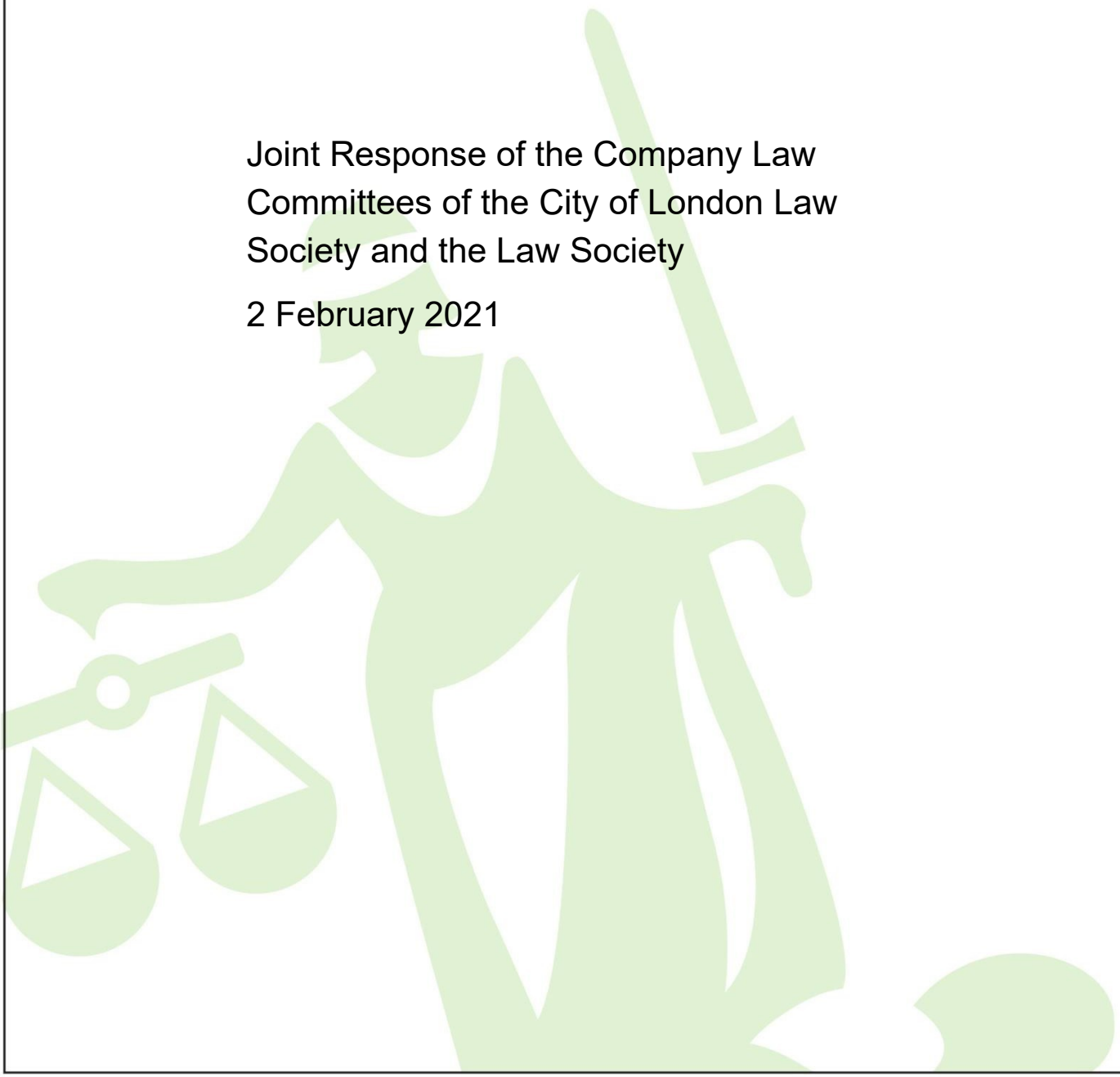
The Law Society

# Corporate Transparency and Register Reform

## Consultation on implementing the ban on corporate directors

Joint Response of the Company Law Committees of the City of London Law Society and the Law Society

2 February 2021



**JOINT RESPONSE OF THE COMPANY LAW COMMITTEES OF THE LAW SOCIETY AND THE CITY OF LONDON LAW SOCIETY TO THE CORPORATE TRANSPARENCY AND REGISTER REFORM CONSULTATION ON IMPLEMENTING THE BAN ON CORPORATE DIRECTORS**

## 1. INTRODUCTORY COMMENTS

1.1 The views set out in this paper have been prepared by a Joint Working Party of the Company Law Committees of the City of London Law Society (**CLLS**) and the Law Society of England and Wales (the **Law Society**).

1.2 The CLLS represents approximately 17,000 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, multijurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees.

1.3 The Law Society is the professional body for solicitors in England and Wales, representing over 170,000 registered legal practitioners. It represents the profession to Parliament, Government and regulatory bodies in both the domestic and European arena and has a public interest in the reform of the law.

1.4 The Joint Working Party is made up of senior and specialist corporate lawyers from both the CLLS and the Law Society.

1.5 As a general comment, we welcome the proposed exception, which we think will facilitate business efficiency without compromising transparency. We have, however, identified some specific situations in which the proposals may present a problem for legitimate business structures, and we have suggested some solutions to those. We also have some questions and comments about the proposed consequences of different scenarios, including where a corporate director is appointed to the board of an entity which is itself a corporate director.

## 2. RESPONSES TO CONSULTATION QUESTIONS

### 2.1 Question 1: In your view, will the proposed 'principles' based exception deliver a pragmatic balance between improving corporate transparency and providing companies adequate scope to realise the legitimate benefits of the use of corporate directors?

We consider the proposal to strike a broadly pragmatic and workable balance.

We note that section 156A(1) CA 2006 refers to who may be "appointed" as a director of a company, rather than who may hold that position. So, for example, if Company 1 appoints Company 2 (which at that time has all natural directors) as a director, the legislation does not appear to have any impact if Company 2 subsequently appoints a corporate director to its own board. We assume this will be addressed in the regulations made under section 156B CA 2006.

The consequences of any breach will also need to be addressed. It is worth noting here that a company may not have control over who is appointed as a director of it. Under section 156A(3) an appointment in breach of section 156A(1) and the exceptions made by regulation will be void. Because this has the effect of changing who a company's directors are, and may affect the ability of a company to hold a quorate board meeting (and validly transact business), we would suggest that, in the event of a breach, the regulations should provide a short grace period (eg one month) for the situation to be remedied.

**2.2 Question 2: Bearing in mind the transparency objective, is the scope of the exception proportionate and reasonable?**

Yes.

We consider ID verification of all relevant natural persons by Companies House to be a reasonably straightforward and workable solution.

We support the inclusion of overseas companies within the exemption, although in our experience it is relatively unusual for overseas companies to be corporate directors of UK companies. However, in the case of an overseas company, it may be less straightforward to determine who the directors of that overseas company are if the jurisdiction in question does not have a public register. Guidance as to what may be an appropriate way of establishing this in such jurisdictions would be helpful (although this should not be prescriptive or exclusive).

To achieve the objective of transparency to the public, is it intended that the identity of the natural person directors of an overseas corporate director should also be disclosed and made available to the public, perhaps when appointing the director and as part of the annual confirmation statement?

**2.3 Question 3: Assuming that ID verification will form a fundamental element of the corporate director regime, what do you see as the arguments for and against allowing LPs and LLPs be appointed as corporate directors? If they are to be allowed, how should the principle of natural person directors apply within these partnership models?**

**LPs**

As an English Limited Partnership does not have separate corporate personality, it could not currently be appointed as a corporate director, and we see no reason to change this.

**LLPs**

We would support the possibility of an LLP being appointed as a corporate director, although this is something we see rarely in practice. In relation to determining the identity of the people "behind" an LLP, we would note that a designated member of an LLP is not akin to a director of a company. Having said that, where an LLP is a director of a UK company, we consider – on balance – that requiring the designated members of that LLP to be natural persons is a workable solution. As acknowledged in the consultation paper, it is very important not to restrict who may be a member of an LLP, as corporate members of LLPs are used in a wide variety of legitimate scenarios.

We also wonder how this will work where a non-UK LLP, which may not have designated members, acts as a corporate director. Will that non-UK LLP be required to have managing members who are natural persons?

**2.4 Question 4: Do these reporting requirements appear proportionate and reasonable?**

Overall, yes.

In relation to UK companies, the position is relatively straightforward. It would be helpful if the new Companies House system (once up and running) could automatically flag any breach to the companies involved. As noted above, in the event of any breach, we think it would be desirable to allow a short grace period for the breach to be remedied. A prompt notification system combined with a grace period would allow the companies involved to seek to resolve the situation promptly and before issues arise in relation to a company's ability to hold quorate board meetings and transact business.

In relation to overseas companies and the annual confirmation requirement, although it may take longer for any breaches to come to light, we agree it seems reasonable to require Company C in your example to assure itself that Company D has no corporate directors. Again, a grace period, allowing the situation to be resolved before issues arise as to the validity of business transacted, would be desirable.

We note the proposals treat UK and non-UK corporate directors differently. To illustrate this using your example, if C appoints UK company D as its corporate director – the regulations could be framed so as to make any attempt by D to appoint E as a corporate director ineffective. However, if company D is an overseas company, the UK would have no jurisdiction over any attempt by D to appoint E as a corporate director (although it would be open to UK regulations to provide that, in these circumstances, D no longer falls within the exception which allows it to be a director of C). It may therefore be that the consequences of any attempted breach (and the related triggers and grace periods) will differ in relation to UK and non-UK corporate directors.

**2.5 Question 5: Does the Impact Assessment provide a reasonable assessment of the costs and benefits of the prohibition and possible exceptions? In particular:**

- **Do you have any evidence as to why companies have reduced their use of corporate directors since the primary legislation was passed?**

  In our experience, a number of companies have done this in view of the upcoming prohibition, to avoid having to make changes when it comes into effect.

- **Do you have any evidence on what might be the costs to companies from the proposed restrictions on corporate directors?**

  No comment.

**2.6 Question 6: What are your views on applying the proposed Corporate Director principles more broadly to a) LLPs, and b) LPs, and how would you envisage ID verification operating in those contexts?**

**(a) LLPs**

As noted above, a designated member is not a quasi director, and it is important not to prevent LLPs from having corporate members; doing so would have an effect equivalent to banning corporate shareholders of companies and would create serious and costly issues within many perfectly legitimate group structures.

Having said that, if the requirement were to be that a company may only be a designated member of an LLP if all of its directors are natural persons – in most cases, we consider that this would be workable. We do see LLPs with corporate members – for example, in asset management businesses, sometimes in real estate joint ventures and sometimes within wholly owned group structures (often for funding purposes) – but in most cases the corporate member is a company with natural person directors.

However, such a requirement could cause significant issues in the pensions context. Many pension trustee companies have a professional corporate trustee on the board. Ensuring the boards of these professional corporate trustees consist only of natural persons should be achievable, but the problem arises in relation to the funding structures of some large pension schemes. In some such schemes the pension trustee company is a member of an LLP (alongside the sponsor company). Under the proposal, where the pension trustee company is a designated member of the LLP, it would be unable to continue to have a professional corporate trustee on its board. Removing that professional trustee input could be detrimental to the governance and running of the pension scheme. This type of structure

is generally established to support a pension scheme's funding for 20 or 30 years, so disrupting the funding arrangement would be detrimental to the scheme. If similar principles are to be applied to LLPs, an exception should be provided for pension schemes (which are already quite tightly supervised from a tax and Pensions Regulator perspective).

As an alternative to providing an exception to address this pensions issue, perhaps the principles could be applied slightly differently in an LLP context, allowing an additional "layer" of corporate directors. The rules could provide that in any case where an LLP's designated member is a company (or perhaps another corporate) which is itself subject to the new regime relating to corporate directors, the restrictions do not apply. This may be a more simple approach, and more in line with the "principles based" approach.

Professional partnership structures could also be affected if similar principles were to be applied to LLPs. These structures may comprise a number of related LLPs. For example, an LLP ("A") may have another LLP ("B") as a designated member. It is also possible that a third LLP ("C") may be inserted above LLP B in the chain. Equivalent principles to those suggested in relation to companies (which would allow B to be a designated member of A only if B's own designated members were all natural persons) would prevent C from being a designated member of B. These arrangements are put in place for reasons of regulatory compliance and ease of management, and this seems an unnecessary fetter on what is a legitimate business structure. This situation could be addressed either by exempting corporates which are themselves subject to the new regime from the restriction (as suggested in relation to the pensions situation above) or by permitting a further exception in relation to highly regulated operations such as professional services firm structures (used by lawyers and accountants) and FCA regulated entities.

**(b) Limited Partnerships**

English limited partnerships do not have separate corporate personality, and we do not see the rationale for seeking to apply similar principles to them.

We do see some funds structured (typically for private equity carried interest planning purposes) so that an English limited partnership has a Scottish limited partnership (with legal personality) as its general partner, and the general partner of that is a Scottish company (whose directors are typically natural people). These structures would be impacted if similar principles relating to the banning of corporate directors were to be applied to them. We would suggest that this is investigated further (for example with the British Private Equity & Venture Capital Association) as this change could have a very significant impact on the UK funds sector.

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