Transparency and Trust
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By e-mail: transparencyandtrust@bis.gsi.gov.uk

20 September 2013

Dear Sirs

Response to BIS discussion paper, Transparency & Trust: Enhancing the Transparency of UK Company Ownership and Increasing Trust in UK Business

I am writing on behalf of GC100 to respond to the above discussion paper.

GC100 is the association for the general counsel and company secretaries of companies in the UK FTSE 100. There are currently over 125 members of the group, representing some 81 companies.

Please note, as a matter of formality, that the views expressed in this letter do not necessarily reflect those of each and every individual member of GC100 or their employing companies.

Our responses take the form of responses to certain, but not all, of the questions raised in the discussion paper, although they are aimed at providing a broader commentary on the theme of transparency and trust. Our views are as follows:

Part A: A central registry of company beneficial ownership information (questions 1-26)

In general we support the case for openness and transparency in business.

We recognise the issues around the control of companies that the proposals seek to address and consider that there are merits in aligning the definition of "beneficial owner" with that used in the Money Laundering Regulations 2007.

The proposals recognise that companies listed on the main market of the London Stock Exchange are already subject to the stringent ownership disclosure requirements provided for under the Companies Act 2006 and the Disclosure & Transparency Rules (DTRs). We also note that, under the Listing Rules, listed companies are also required to include in the annual financial report a statement showing interests disclosed to it in accordance with DTR 5. Likewise, companies quoted on the AIM market are also required to comply with the DTRs. We therefore strongly agree with the government's provisional view that there would not be added value in additional information about the beneficial ownership of these listed or quoted companies being held in a central registry. In addition, we consider that wholly owned subsidiaries of such listed or quoted companies should also be exempt from the proposed requirements (information on subsidiaries is disclosed in the annual return).

In relation to other companies (i.e. companies other than listed or quoted companies and their

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wholly owned subsidiaries):

- We believe that the information that listed companies can obtain under the current regime in establishing beneficial ownership is valuable and the proposals should reflect this. Not all unlisted companies are closely controlled, and it cannot be assumed that officers of the company will always be aware of arrangements between legal shareholders and third parties. Whilst the Companies Act 2006 currently enables public companies to make enquiries of its shareholders, this can be a time-consuming and costly exercise and does not always yield satisfactory results, particularly where shareholders are based in jurisdictions with strict privacy laws. Thus we believe that the onus on identifying significant beneficial ownership should rest with the shareholder/beneficial owner and not with the company. The responsibility for notifying the company of any change in beneficial ownership should also lie with the shareholder/beneficial owner (as is required in DTR 5 for shareholders of listed companies).

  For the regime to work there would need to be a parallel obligation on both legal and beneficial owners to disclose beneficial ownership details to the company with some form of penalty for non compliance.

- In terms of how the information is provided to the registry, it should be noted that companies are not required to update the registry of its shareholders on a real-time basis. This information is provided to the registry annually when the company submits its annual return. It would be inconsistent (and costly, therefore an increased burden on business) to require companies to update information at the registry on beneficial ownership more frequently than they are currently required to update shareholdings. A practical way forward would be to extend the annual return to capture beneficial owners of over 25 per cent of the company as well as legal shareholders.

- In terms of public availability of information, we consider that information on beneficial ownership should be available to the public in a similar manner to information on legal ownership but there may be a case to allow companies to apply for exemption from public disclosure on the basis of safety, along the lines of confidentiality orders for directors where harassment or identity fraud may be an issue.

Part A: Abolition of bearer shares (questions 27-30)

There are legitimate reasons for using bearer shares:

- Protection of individuals involved in "controversial" activities (such as animal testing)
- Maintaining competitive advantage
- Set up of certain corporate structures

There are two issues of transparency involved in the use of bearer shares. One is whether the company knows who is holding the shares, and the other is whether this information is publicly available.

The blanket prohibition of bearer shares could have significant commercial impacts on corporates who currently use them for legitimate purposes. Even a ban on issue of new bearers could cause problems, as existing bearers sometimes need to be re-issued where they support certain types of corporate structures.

There is some doubt over whether the abolition of bearer shares would significantly impact the

stated aims of reducing tax evasion or hiding criminal activity. Persons wishing to hide such activities have other ways to do so, so the majority of legitimate users would be penalised while not affecting the criminal minority.

In general we feel that the legitimate use of bearer shares could be supported while addressing the transparency issues as follows:

1. Holders of bearer shares must disclose their identity to the company; the company could be required to withhold dividends and freeze shares and voting rights if the disclosure is not made.
2. Companies must disclose the owner of the shares on an annual basis e.g. in the annual report.
3. Companies can apply for exemption from public disclosure on the basis of safety, along the lines of confidentiality orders for directors where harassment or identity fraud may be an issue, but must make a confidential disclosure to Companies House in any case.

In the event of an introduction of a ban on new bearer shares, we strongly feel that existing arrangements should not be affected. If existing bearer shares must be converted, a lengthy period of time (such as 5 years) should be allowed in order to let corporates re-arrange structures as required.

Part A: Nominee directors (questions 31-34)

We note that directors are appointed by the shareholders so in effect are their nominee. However, BIS' use of the term is unclear and we think that more clarity is needed regarding what constitutes a nominee, and how an individual identifies them-self as such.

For large listed companies or groups of companies, employees of the group may be asked to be a director of a subsidiary as they are best placed, having knowledge of the company and its operations, to undertake that role. Thus an individual, for example within a finance or legal role, may be appointed to a significant number of companies within a group. As companies are required to list their subsidiary companies in the Annual Report or with their Annual Return there is transparency for such groups already. We would recommend therefore that where the ultimate holding company is listed on a stock exchange, such directors are not required to be identified as a nominee director.

Nominee directors are also frequently used for shelf companies for ease of administration. Changing this could prove costly without any obvious benefit as the companies are not trading.

If additional disclosure is required for private limited companies to assist with transparency, then we would suggest that this disclosure is made on Companies House form AP01 (Appointment of director), whereby the director would need to disclose their nominator. Similarly, we think that the form AP01 should be amended to identify if someone is acting as an alternate to a director (and identify that director).

In terms of cost, in group situations, if all companies had to identify nominee appointors, this would take some time and the assumed wage of £11.50 an hour is somewhat conservative in our experience. If this was outsourced to a third party company secretaries firm for example, we would estimate this at c£50 a company to include updating the company's records and filing the documents at Companies House. In addition there would be an ongoing cost for any future changes in composition of the board.

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Part A: Corporate directors (questions 35-38)

We note your comments regarding corporate directors.

Large companies such as those represented by GC100 frequently utilise corporate directors in order to widen the pool of meeting attendees and signatories for documents. This makes internal governance and administration more efficient. For example a board meeting can be held using two corporate directors rather than two individuals who may not be available. The total number of people who can attend on behalf of the corporate directors, and therefore ensure the appropriate business is transacted, is far greater, making it easier to hold the meeting. In addition, such people may be able to sign documents on behalf of the corporate director. Companies that legitimately have numerous subsidiaries find it offers more flexibility to have a number of signatories for such corporate directors to reduce over reliance on one or two individuals. One company reported that they sign c3,000 documents a year which would be onerous for one person to sign!

It should be noted that corporate directors in a group situation do not need to be trading companies since they are not conducting business through that company, but merely act as directors – thus dormant companies can legitimately be corporate directors.

For UK companies with an international presence, it should be noted that some jurisdictions require directors to own shares in the company even if they are appointed by the UK company. By having UK corporate directors, such restrictions can be managed more easily for both the individual and the group, particularly in the context of joint ventures.

In terms of transparency, we also note all companies in England and Wales are currently required to have a natural person as a director so query whether the proposals would assist in its objectives. We would therefore object to the prohibition of the use of corporate directors since alternatives would be costly to the company and not increase transparency of the beneficial owner.

Corporate directors are also used for Investment Companies with Variable Capital (ICVCs) - indeed the role of the "Authorised Corporate Director" is a defined role in financial services regulations (see the Handbook of the Financial Conduct Authority). If corporate directors were to be prohibited then this would likely require an exemption.

As mentioned for the appointment of a Nominee Director, there would be the opportunity for private limited companies where the ultimate holding company is not a listed company, to amend Companies House form AP02 (Appointment of corporate director) to include identifying the ultimate appointor of the Corporate Director.

Part B: Clarifying the responsibilities of directors in key sectors (question 39)

The merits of strengthening responsibilities of banking directors by amending the directors' duties in the CA06 (Companies Act 2006) to create a primary duty to promote financial stability over the interests of shareholders. This should be considered in the context of the banking regulation reforms the Government has already committed to and the further economy-wide measures set out in the rest of this paper.

We are firmly of the view that an amendment to the statutory duties of banking directors in the CA06 would be an inappropriate and misguided course of action in response to the recommendations contained in the Report of the Parliamentary Commission on Banking Standards (PCBS). We are of the view that any such changes should be incorporated in regulation and,

specifically, within the proposed Senior Persons regime.

The Discussion Paper raises some very relevant questions about the duties owed by directors in specific sectors. In undertaking their primary duty to promote the success of the company for the benefit of the members as a whole, directors are already required to consider the wider effects of their actions under section 172 of the CA06. Analysis of the events giving rise to the global financial crisis identified that the judgements of the directors of some banks had been influenced by the primacy of shareholders' interests at the expense of the interests of other stakeholders, or the wider effect of those judgements on those other stakeholders. As a consequence, it is recognised that additional provisions may be justified where there is a potential difference between the risk appetite of individual firms in the banking sector and their directors and the level of risk which the Government is willing to accept on behalf of the wider population. As highlighted in Para 8.12 of the Discussion Paper, if this approach is adopted in the form of a qualitative assessment by Government of the acceptability – or otherwise – of a company's stated risk appetite, we believe that it would need to be applied beyond the banking sector to other critical sectors and activities undertaken by companies to which the CA06 applies.

This raises two questions:

(a) To what extent should this approach be enshrined in primary legislation?

The instinctive reaction to the PCBS recommendations may be to amend the common law and equitable duties of directors as now codified under section 172 CA06 so as to enshrine requirements on directors of large banks to prioritise the "safety and soundness" of the firm first over the interests of shareholders.

We are not convinced that detailed obligations specifically applying to the directors of large banks should be contained in the Companies Act. Further, a requirement for directors of large banks to prioritise the "safety and soundness" of the company over the interest of shareholders implies that the two are mutually exclusive, whereas maintaining the financial viability of any company is a subset of ensuring the success of the company.

We agree there has to be an appropriate balance between financial safety and soundness and shareholder return. However, we consider that modification of the statutory duty is not appropriate and would not achieve this appropriate balance. The duty to promote the success of the company contained in section 172 already CA06 requires directors to have regard to "the likely consequences of any decision in the long-term". This therefore requires directors to promote the safety and soundness of the bank.

The new proposal would create much greater uncertainty for the boards of UK companies than the duties already well established in English law. We believe that the imposition of a legislative solution in this form would be very difficult for the Government and the boards of UK companies to manage, raising potential conflicts of interest, complexity and uncertainty.

Creating a two-tier standard for directors' statutory duties could also have value implications for banks affected, relative to those where directors have a clear and express primary duty to act in the best interests of all shareholders. Bank directorships could become less attractive - particularly with the other changes being proposed by the PCBS. Investors may consider banks a less attractive investment than other types of companies, ultimately affecting bank share prices and the economy.

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Overall, we consider that the most appropriate place to address this general principle is through the Principles for Businesses and the Senior Persons regime, as contemplated by the PCBS Report. These will apply to all banks authorised by the Prudential Regulatory Authority (PRA) and not just those which are incorporated or listed in the UK. Guidance would need to set out clearly what was expected of directors in discharging this duty. Breach of the duty would be a breach of regulatory rules and leave the director in question liable to action and sanction by the PRA. This should be an effective deterrent, recognising that this regulatory duty would have to be read in the light of the statutory duty under the Companies Act 2006. The wider sectoral picture is also very relevant - a huge number of rules and regulations have been put in place and continue to be put in place to ensure banks are financially sound and adequately capitalised. A new criminal offence of "reckless misconduct" is also being considered by the Government, following the PCBS Report. What's more the PRA and Financial Conduct Authority (FCA) now have a strong focus on individual responsibility and enforcement against individuals as well as firms. Adding a statutory duty on top of all of this is unnecessary and would only create confusion if it was interpreted differently to the sectoral standards.

We agree that the alternative which BIS suggests of improving enforcement instead of creating this new duty would be the better approach than a new statutory duty.

(b) How the Government's risk appetite is to be expressed?

For directors to be able to give proper consideration to their wider responsibilities, for example, on health and safety, business continuity, national security or financial stability, the Government would need to be clear about its own risk appetite and how that should be interpreted by firms in the UK banking sector.

The recommendations from the PCBS provide an example of the need for clarity on the specific requirements. The PCBS has recommended that in interpreting their duties the "directors of banks [should]… attach the utmost importance to the safety and soundness of the firm". The danger with this formulation is that it leaves little room for compromise; "utmost" is a standard which implies that nothing else could have been done to ensure the objective is achieved. Given these terms, the extremity of the actions which directors then take should match the ultimate nature of burden placed upon them. Arguably, under these conditions, no bank could make any loan which was not matched by 100% capital requirements, with an additional margin to account for operational risk, without being at risk of being found guilty of not having taken the 'utmost' steps to secure the firm's financial stability. Safety and soundness should be a factor to which the directors must have regard, but the importance attached should be appropriate and proportionate in the circumstances.

The proposed duty could bring about the wrong outcomes by creating overly risk-averse behaviours and stifling healthy innovation.

The position set out in the Discussion Paper is more nuanced and considers a 'primary' objective which leaves more scope for discretion whilst still setting out a hierarchy of requirements. However, even that position needs to be considered carefully: The Chancellor has commented that we do not want 'the stability of the graveyard', making it clear that there is a trade-off between objectives of financial stability and economic activity. However, we consider that this still needs to be spelt out in more detail.

All of this illustrates the need for flexibility in the development of these sectoral

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responsibilities, ideally in the form of secondary legislation or through regulation to adapt to changing circumstances.

Part B: Allowing sectoral regulators to disqualify directors in their sector (questions 40–42)
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? 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? The potential costs and benefits of this proposal?

The Discussion Paper makes a case for directors who are being barred from all senior positions in a sector for breach of their sectoral requirements to be prohibited from acting as a director of any UK company; the argument goes that if they cannot operate within the constraints imposed in one particular sector, why should they be trusted to do the same in another. There may be some merit in this argument but it does not seem appropriate to conclude that if a director is to be barred from acting in a senior position in one particular sector that he should automatically be barred from acting as a director of any company. For example, there may be a dispute about whether the sectoral regulations with which the director was required to comply were sufficiently clear, with the governing body inclined to support its own case. In this case, it would seem more appropriate if a higher body was available to provide a check-and-balance against the potential extra-sectoral effects.

Part B: Factors to be taken into account in disqualification proceedings (questions 43-49)

Whether Schedule 1 to the CDDA (Companies Directors Disqualification Act) 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?

In line with the position set out above, we believe that any breach of sectoral regulations should be taken into account by the court in disqualification proceedings. But at the same time, it would be important for the court to consider whether those sectoral regulations were sufficiently clear on the directors' duties and whether the director had taken any opportunity to clarify those regulations with appropriate persons.

Whether Schedule 1 to the CDDA should be amended to provide that 'wider social impact' is a matter of unfitness that may be taken into account by the court in disqualification proceedings? How 'wider social impact' should be defined and whether a materiality test should be applied?

In principle, we believe that the 'wider social impact' could be a consideration in disqualification proceedings but the terms on which that is determined do need to be considered carefully.

- It would be important that this is limited to the impact which could have reasonably been foreseen by the relevant director, in particular taking into account any sectoral regulations which identified possible risks. It must not be extended to second order effects, such as wider questions of confidence in any section of the economy or society.

- The impact needs to be measurable in terms of costs and losses which have been suffered by those affected taking into account any warnings which had been given to those who suffered costs, losses or inconvenience and any reasonable mitigation that they could have taken. For example, if there is the potential for a break in the supply of an essential service, was notice given of that possibility and alternatives or mitigants provided.

- There needs to be a consideration of materiality judged both in absolute terms and compared to the state of the party which is affected. Small losses on a large number of individuals may not amount to a material amount in aggregate but they could impose significant difficulties if those individuals are amongst the poorest in society. This could be difficult to judge but directors should be aware of the nature of their customer base and, therefore, their potential to create issues which are material for those individuals.

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;*
- *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 they had been disqualified)*

Whether Schedule 1 to the CDDA should be amended to provide that failure to pay particular regard to 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)?

There may be some merit in having a different tariff in respect of breaches of sectoral regulations where these affect parties which are vulnerable and unable take advantage of mitigants and alternatives. This would be particularly the case where these risks have been highlighted in sectoral regulations but it is clear that the director had been unable to appreciate the nature of the duties in this respect. In line with our earlier views, however, we are unconvinced that the sectorally specific requirements, for example, on banking and depositors, should be included in the primary legislation.

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?
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?

We would support and endorse the court (and the Secretary of State when deciding whether to take action) taking the track record of the director (including the number of failures a director has been involved in) into account when deciding whether or not to disqualify an individual and for how long. However we do not think there should be a specified number of failures beyond which the presumption is that a director is unfit and should be disqualified. In our view, the size and materiality of the director's failures are more pertinent considerations.

Part B: Educating directors (questions 64-68)

Director education is an important part of ensuring business success. However, any director education must be tailored and specific if it is to address the real issues underlying poor performance. In the context of using director education and training as a means to mitigate disqualification, it would be unfortunate if generic education or training came to be seen as a tool to reduce the length of a disqualification period.

The UK Corporate Governance Code requires that the chairman should regularly review and agree

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with each director their training and development needs. This recognises the need for any training to be specific and bespoke.

Individuals who are serious about learning from past mistakes are likely to embrace education, but whether this should lead to a reduction in a disqualification period would need to be considered on an individual basis.

Overall the training proposed may be "too little, too late" – perhaps training at the start of a directorship might be more effective in achieving the Government's aims.

Part B: Extending overseas restrictions (questions 69-72)

The proposals to enable those dealings with companies to check that the officers of those companies are not subject to restrictions are welcomed, as are the proposals to prevent a person who is subject to foreign restrictions from being a director of a UK company. We also support the proposal to enable disqualification proceeding to be brought in respect of a person convicted of a criminal offence in connection with the management of an overseas company.

We would welcome the opportunity to discuss these issues with you further.

Yours faithfully

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