

Economic Crime and Corporate Transparency Bill

Written evidence submitted by R3, the insolvency and restructuring trade body (October 2022)

Executive summary

- About R3
- Overview
- Background
- The need to reform Companies House's automatic strike-off power
- Making the restoration of a company an administrative process
- Resourcing of the Registrar's querying powers

About R3

1. R3 is the trade association for the UK's insolvency, restructuring, advisory, and turnaround professionals. We represent licensed insolvency practitioners, lawyers, turnaround and restructuring experts, students, and others in the profession.
2. Our members work across the spectrum of the profession, from global legal and accountancy firms through to smaller, local practices. Our members have direct experience of insolvencies and their impact on individuals and businesses across the UK.
3. The insolvency, restructuring and turnaround profession is a vital part of the UK economy. The profession promotes economic regeneration, resolves financial distress for businesses and individuals, saves jobs, and creates the confidence and public trust which underpin trading, lending and investment.
4. Our members play an important role in the fight against fraud and in supporting the integrity of the UK's corporate governance framework.
5. Insolvency professionals have a unique perspective as users of Companies House. When appointed over insolvent companies, they are required to investigate a company's affairs and director conduct, partly by referring to its books and records, in order to discharge their duties. Furthermore, the ability to access corporate records and information about directors and quickly identify where such information is either missing or inaccurate is key to the work of insolvency practitioners, as part of their legal duties to prepare a report about the conduct of any person who has been a company director. To this end, Companies House plays a crucial role in enabling insolvency practitioners to carry out their work to tackle fraud.

Overview

6. The *Economic Crime and Corporate Transparency Bill* will introduce long-awaited reforms to Companies House, alongside other measures which aim to strengthen the UK's corporate governance framework.
7. R3 welcomes the introduction of this Bill, having long called for the reform of Companies House and for the tightening of procedures around company formation and oversight. We strongly support much of what the Bill proposes, particularly the introduction of Companies House identity verification for directors and Persons of Significant Control (PSCs).
8. However, the Government has missed a crucial opportunity to truly close some of the loopholes currently exploited so easily by fraudsters. The Bill's proposals will be limited in their efficacy to bring about real change to preventing and disrupting economic crime if companies used as vehicles for fraud continue to be dissolved and struck off the Companies House register automatically, with next to no due diligence carried out to ascertain whether the company has been involved in fraudulent activity, and with no clear avenue for the company's assets to be identified and distributed back to creditors when fraudulent companies are struck-off the register.

It is therefore important that the Government addresses the following key points:

- **How will the reforms successfully provide a deterrent to those that commit repeat frauds?**

The Bill's explanatory notes state that "the Government would like to see Companies House have an expanded role so will change its statutory role from being a largely passive recipient of information to a much more active gatekeeper over company creation and custodian of more reliable data."

However, it is not clear how the proposed reforms – including the new requirement for identity verification of new and existing registered company directors, PSCs, and those delivering documents to the Registrar, and the Registrar's new powers to query, change, remove and refuse misleading information or documents – will significantly improve the current deterrents to culpable directors.

R3 members and other stakeholders report that those who commit economic crime are often repeat offenders, with a number of individuals responsible for a volume of the frauds that take place within the UK. Although these individuals are the ultimate economic beneficiaries of the fraud, it is not uncommon for other individuals to be listed as the company's directors. Therefore, while the Bill's proposed new requirements for identity verification of directors, PSCs, and those delivering documents to the Registrar will go some way to improving the tackling of economic crime, the results may not necessarily prove as widespread as the Government might have hoped.

A much more significant deterrent for culpable individuals is being held to account for the assets that have been misappropriated and incurring personal liability for wrongful actions – such as when the company is put through an insolvency process.

- **What will the Government's approach be to dealing with fraudulent companies that are struck-off the Companies House register?**

The Registrar's new powers include a discretionary power to change the address of a company's registered office without an application where the Registrar is satisfied that the company is not authorised to use the address. The Government has said that the Registrar will have the power to change a company's address to Companies House's own address, and to then strike the company off the Companies House register.

Around 400,000 companies are dissolved and struck-off the Companies House register each year. Around 94% of these are struck-off due to failures to file accounts or confirmation statements, rather than at the request of directors or the courts. However, through the current automatic strike-off procedure there is very little due diligence carried out by Companies House and others to identify whether or not fraud has occurred. This allows directors to either rack-up debts or sell company assets ahead of the company being dissolved, and to effectively abscond with the proceeds.

R3 urges the Government to reform Companies House's automatic strike-off procedure. It would result in more effective investigation of insolvent company dissolutions – and crucially provide a much stronger deterrent to culpable directors – if instead of companies being automatically struck-off, those that have failed to file accounts when due were automatically placed in a compulsory liquidation procedure, a process which would be overseen by the Government's Official Receiver. This would allow for earlier investigation into the conduct of directors and for the earlier recovery of misappropriated company assets – for the benefit of all of the company's creditors.

- **How will the Registrar's querying powers be adequately resourced to allow for effective improvement of the accuracy of Companies House's register?**

The Bill gives the Registrar powers to proactively query the accuracy of information received by Companies House, and to change, remove and refuse misleading information or documents where

deemed necessary. The Bill's Impact Assessment states that the power will be exercised "using a risk-based approach, which will enable the Registrar to prioritise those filings that pose the most risk to the integrity of the register, including potentially suspicious or fraudulent activity".

The Government has not laid out how the Registrar will be adequately resourced so that this new proactive querying power is actually significantly effective at making a real difference in targeting many of the companies who have submitted fraudulent information to the register. Resourcing issues may mean that fraudulent companies do not always reach the attention of the Registrar.

In order to allow them to effectively discharge their statutory duties – and crucially to allow a wider body of professionals will more effectively be able to carry out investigations into corporate affairs and director conduct, thereby identifying and disrupting more frauds – we recommend that insolvency practitioners be able to request access to Companies House's non-public information pertaining to any other corporates linked to that of the entity to which they have been appointed.

Background

9. Among other proposals, the Bill intends to reform the role of Companies House and improve transparency over UK companies and other legal entities to combat economic crime. The Bill's Impact Assessment says that the reforms to Companies House aim to address three "core issues": 1) increasing timeliness, usefulness, and accuracy of Companies House data; 2) misuse of UK registered companies and other entities; and 3) meeting high levels of demand for Company House services.
10. The Government's proposals to reform Companies House and the companies register were initially set out in its 2019 and 2020 consultations. The Government has also recently taken further steps to improve the UK's corporate governance framework, such as by granting the Insolvency Service the power to investigate directors of dissolved companies through the Rating (Coronavirus) and Director Disqualification (Dissolved Companies) Act 2021, as well as through the recent Economic Crime (Transparency and Enforcement) Act 2022.

The need to reform Companies House's automatic strike-off power

11. Currently, Companies House automatically strikes-off around 94% of the total number of dissolved companies each year due to failures to file accounts or confirmation statements, rather than at the request of directors or the courts. This can be seen in the table below.

Year	Dissolved companies ¹	Percentage of companies struck off and dissolved ²	Percentage of companies wound up voluntarily or subject to the supervision of the Court under the Companies Acts ³
2019/20	531,590	95%	5%
2018/19	504,307	94%	6%
2017/18	486,671	94%	6%
2016/17	432,347	94%	6%
2015/16:	395,606	94%	6%
2014/15	365,881	93%	7%
2013/14	329,245	93%	7%
2012/13	299,700	92%	8%
<i>Average</i>	<i>418,168</i>	<i>94%</i>	<i>6%</i>

12. It is estimated that 50% of the automatic strike-offs by Companies House are of insolvent companies – around 12 times more insolvent companies than the annual number of corporate insolvencies. The automatic dissolution of an insolvent company means that the company must first be restored in order for investigation into the conduct of its directors and the recovery of its assets to take place.
13. R3 members and other stakeholders note that those who commit economic crime are often repeat offenders, with a number of individuals responsible for a volume of the frauds that take place within the UK. Although these individuals are the ultimate economic beneficiaries of the fraud, it is not uncommon for other individuals to be listed as the company’s directors. Indeed, the Bill’s Impact Assessment notes that “corporate structures can make it difficult to identify the individuals responsible for criminal activity - resulting in less efficient and effective investigations” and that “investigations and recovery are often even more complex where the relevant parties are based abroad”. The Bill’s proposed new requirements for identity verification of directors and PSCs alone will therefore be limited in their effectiveness to target those economic beneficiaries.
14. Although the *Rating (Coronavirus) and Director Disqualification Act 2021* granted the Government with powers to investigate and disqualify a director of a dissolved company for fraud, wrongful trading or director misconduct, R3 members report that disqualifications alone have had little to no effect on fraudulent directors, and that ‘serious’ rogue directors do not see being disqualified as a significant deterrent, and will often go on to commit repeat frauds. Our members frequently see disqualified directors contributing to successive business failures or breaching the terms of their disqualification by working as shadow directors or “advisors.” With such measures actually targeting directors directly but providing such little deterrent, it is unlikely that the introduction of powers for the Registrar to query or change information will deter such individuals from committing further economic crimes.
15. A much more significant deterrent for directors is being held to account for the assets that have been misappropriated and incurring personal liability for wrongful actions – such as when the company is put through an insolvency process.
16. While the Government can use Compensation Orders to recover losses to creditors where a director of a dissolved company has been disqualified, Compensation Orders were introduced to benefit a narrow group of creditors directly affected by the misconduct of a director, rather than the overall body of the company’s creditors. Given that culpable directors often go on to commit repeat frauds, using a Compensation Order

¹Companies House (2021). [Companies Register Activity 2020/21](#), Table A9: Companies removed from the register, 2012-13 to 2020-21

²*Ibid*

³*Ibid*

means that the many other frauds that may be carried out by these same directors simply will not get investigated or identified because the company is left dissolved.

17. It is important that the Government acts to reform Companies House’s automatic strike-off procedure. Instead of companies being automatically struck-off, those that have failed to file accounts when due were automatically placed in a compulsory liquidation procedure, a process which would be overseen by the Government’s Official Receiver. This would allow for earlier investigation into the conduct of directors and for the earlier recovery of misappropriated company assets – for the benefit of all of the company’s creditors – including the Government itself. The directors of such companies could be made personally liable for the costs of the liquidation, which would simultaneously cover the costs to Government and provide a much stronger deterrent to fraudsters.

Making the restoration of a company an administrative process

18. Alongside reforming Companies House’s automatic strike-off process, the Government should make the restoration of a company an administrative process in all instances – so that those companies that have already been dissolved can be more easily restored and put through an insolvency process.
19. As noted above, disqualifications do not provide much deterrent for culpable directors: a much more significant deterrent occurs when the company is put through an insolvency process and the directors are held to account for the assets that have been misappropriated and incur personal liability for their actions. If a company has been dissolved and automatically struck-off the Companies House register (and therefore effectively no longer exists) this can only take place if the company is first restored.
20. Currently, under section 1024 of the Companies Act, administrative restoration is only available to a former director or former member of the company who was a director or member at the time the company was dissolved can apply for administrative restoration. If a creditor of the company (at the time of the company’s striking-off or dissolution), or any former liquidator of the company, wants to apply to restore the company then an application to the court has to be made.
21. However, the court process can deter creditors from pursuing it as a procedure, partly due to the costs (typically £1,500-£3,000) and time (typically 12-18 months) involved. Directors are therefore all too easily able to create a significant barrier to investigating their conduct. The table below shows that only 2% of dissolved companies are put through a process to restore them to the register each year.

Year	Dissolved companies in Great Britain⁴	Percentage of companies restored to the register⁵
2019/20	531,590	2%
2018/19	504,307	2%
2017/18	486,671	2%
2016/17	432,347	2%
2015/16:	395,606	2%
2014/15	365,881	2%
2013/14	329,245	2%
2012/13	299,700	2%
<i>Average</i>	<i>418,168</i>	<i>2%</i>

⁴ Companies House (2021). [Companies Register Activity 2020/21](#), Table A9: Companies removed from the register, 2012-13 to 2020-21

⁵ *Ibid*

Resourcing of the Registrar's querying powers

22. As noted above, the Government has not laid out how the Registrar will be adequately resourced so that its new proactive querying power is significantly effective at making a real difference in targeting many of the companies who have submitted fraudulent information to the register. The Bill's Impact Assessment simply states that "we initially expect the querying power to be exercised more frequently but also expect, as the Registrar's knowledge base develops, that queries will be less frequent, especially since much information with malicious intent would be removed from the register or simply not make it on to the register any more considering the proposed changes."
23. Furthermore, when providing evidence for the number of cases where the Registrar may need to apply the querying power to company names, the Impact Assessment says that the Government "anticipate[s] that there would be very few cases" noting that "the Company Names Tribunal service, which deals with complaints between companies over the registering of names, deals with below two hundred cases a year[...] Most cases are undefended."
24. However, the number of complaints between companies over the registering of names are not a useful benchmark to assess the number of companies that may manipulate their company name to hide fraudulent activity. R3 members often report seeing instances where fraudsters use the simplicity of the company register to create multiple registrations using slightly different spellings of company names. We would note that the abuse of company names is more widespread than the Impact Assessment suggests.
25. While we were pleased to see insolvency practitioners listed as among the groups of people the Registrar will be able to proactively disclose information to in the factsheets accompanying the Bill, resourcing issues may mean that fraudulent companies do not always reach the attention of the Registrar. Furthermore, it is unclear whether insolvency practitioners will be able to request information from the Registrar, or whether they will have to rely on receiving information at the Registrar's discretion.
26. When appointed over corporate entities, insolvency practitioners are required to investigate the company's affairs and director conduct in order to discharge their duties – as required by law. We recommend that insolvency practitioners be able to request access to the non-public information held by Companies House pertaining to any other corporates linked to that of the entity to which they have been appointed.

About R3: R3 is the trade association for the UK's insolvency, restructuring, advisory, and turnaround professionals. For further information please contact R3's Public Affairs Manager, Pim Ungphakorn, on pim.ungphakorn@r3.org.uk or 020 7566 4202.