

Summary: Intervention & Options

Department /Agency: Department for Business, Innovation and Skills	Title: Impact Assessment of Disclosure of Loans to Directors in Company Accounts	
Stage: Consultation	Version: 1	Date: 31 July 2009
Related Publications: Consultation document: Disclosure of loans to directors in company accounts: URN 09/1139.		

Available to view or download at:

<http://www.bis.gov.uk> see page on Consultations

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What is the problem under consideration? Why is government intervention necessary?

As currently enacted due to a drafting error the Companies Act 2006 requires very detailed disclosures of loans, advances and guarantees by banking companies in their accounts. Is this disclosure excessive and if so, should the Government correct this problem? At the same time the Government is seeking views on the wider issues of the disclosure of loans, advances and guarantees to all directors.

What are the policy objectives and the intended effects?

Ensure appropriate transparency in company accounts of the loans made to directors and related parties by companies to minimise the risk of directors abusing their position, whilst not overburdening the user with excessive detail that renders the accounts less usable. Avoid burdening companies by duplication with other disclosure requirements in the Companies Act, accounting standards or Listing Rules.

What policy options have been considered? Please justify any preferred option.

- No change to the legislation, relying on existing legislation, accounting standards and other rules.
- Amending s413(8) of the Companies Act 2006 in the short term to remedy the drafting error.
- Repeal s413(8)
- Consider requiring more disclosure, perhaps more aligned with ss 197-214 of the 2006 Act.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

More detail on costs and benefits is being requested in the consultation document, which is consulting on stakeholder views. There will be a review of the Companies Act 2006 in 2011.

Ministerial Sign-off For consultation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister:

IAN LUCAS

.....Date: 1 August 2009

Summary: Analysis & Evidence

Policy Option:	Description:
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COSTS	ANNUAL COSTS	Description and scale of key monetised costs by 'main affected groups'
	One-off (Transition) Yrs	
	£	
	Average Annual Cost (excluding one-off)	
£	Total Cost (PV)	£
Other key non-monetised costs by 'main affected groups' Costs of providing additional disclosure is negligible.		

BENEFITS	ANNUAL BENEFITS	Description and scale of key monetised benefits by 'main affected groups'
	One-off Yrs	
	£	
	Average Annual Benefit (excluding one-off)	
£	Total Benefit (PV)	£
Other key non-monetised benefits by 'main affected groups' Given the separation of stewardship and ownership in large companies, increased transparency for the users of company accounts of loans etc made to directors.		

Key Assumptions/Sensitivities/Risks

Price Base Year	Time Period Years	Net Benefit Range (NPV) £	NET BENEFIT (NPV Best estimate) £
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What is the geographic coverage of the policy/option?	UK
On what date will the policy be implemented?	
Which organisation(s) will enforce the policy?	BIS/FRRP
What is the total annual cost of enforcement for these organisations?	£
Does enforcement comply with Hampton principles?	Yes
Will implementation go beyond minimum EU requirements?	No
What is the value of the proposed offsetting measure per year?	£
What is the value of changes in greenhouse gas emissions?	£
Will the proposal have a significant impact on competition?	No
Annual cost (£-£) per organisation (excluding one-off)	Micro Small Medium Large
Are any of these organisations exempt?	No No N/A N/A

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)
Increase of £	Decrease of £	Net Impact £

Key: Annual costs and benefits: Constant Prices (Net) Present Value

Evidence Base (for summary sheets)

[Use this space (with a recommended maximum of 30 pages) to set out the evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Ensure that the information is organised in such a way as to explain clearly the summary information on the preceding pages of this form.]

Why are we in this position and what is the problem that we are hoping to address?

1. Section 413 of the Companies Act 2006 (the 2006 Act) deals with disclosures in the notes to accounts of advances, credits and guarantees for the benefit of directors. Section 413 replaced section 232 of the Companies Act 1985 and follows much more closely Article 43(1)(13) of the 4th (78/660/EEC) Company Law Directive and Article 34(13) of the 7th (83/349/EEC) Company Law Directive.
2. The intention of the 2006 Act was to continue to exercise the option available to Member States in article 40(7) of the Bank Accounts Directive¹ to require banks to disclose only aggregate figures for such advances, credits and guarantees. That was the position under the Companies Act 1985. However it has been pointed out to the Department that the effect of s413(8) of the 2006 Act as enacted is to require the information for each director, and not an aggregate figure. As with all companies, there is no requirement for the director to be named. The Government has received representations from banking stakeholders that the law as currently drafted is unclear and may result in banks making many pages of additional disclosure of such matters as individual credit card transactions for each director.

What we are hoping to achieve from what we do?

3. The Government would like to avoid a potentially confusing level of meaningless disclosure, hence any amendment to s413(8) should be in place in time for the year ended 31 December 2009.
4. At the same time the Government wishes to look again at whether the 2006 Act regime provides sufficient information to company members and to other users of the accounts, or whether it should go further than what is required by the Directives by imposing additional disclosure requirements. The purpose of this would be to enable company members to satisfy themselves that there was proper stewardship of the company's assets by the directors. After receiving responses to this consultation, if it decided to make further changes, the Government would then publish draft regulations on its proposed amendments to s413, which would deal with the longer term concerns raised.

Issues

5. Under section 413 there is no requirement to disclose in the notes to the annual accounts, or anywhere else, the names of individual directors who receive loans from their companies and there is also no requirement to disclose loans to, or guarantees for the benefit of, persons connected with those directors;
6. Regulations made under the 2006 Act (the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (S.I. 2008/410) have imposed a new requirement for large companies (including banking and insurance companies) preparing Companies Act accounts to give particulars of transactions entered into with related parties. This corresponds to the obligation on large companies which prepare IAS accounts under IAS 24 (related parties);

¹ Council Directive 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions.

7. Under section 343 of the Companies Act 1985, banking companies and the holding companies of credit institutions were required to maintain a register of loans, quasi-loans and other dealings in favour of directors if those transactions were not disclosed in the company's accounts, and make a statement of the transactions available to the members of the company. Section 343 of the 1985 Act was repealed with effect from 6 April 2007.
8. Section 197 of the 2006 Act requires loans to directors and related guarantees or security to be approved by members but there are exemptions from this requirement. In particular, under s209 no approval is necessary if the loan is made by a "money-lending company" (defined as one whose ordinary business includes the making of loans) provided these loans are entered into in the ordinary course of business, and the value is not greater, and its terms not more favourable, than it is reasonable to expect the company would have offered to a person of the same financial standing but unconnected with the company. Under section 200 public companies and their associated companies cannot make loans to connected persons without shareholder approval. The 2006 Act breaks the link, which existed in the 1985 Companies Act, between the provisions setting out the types of loans which companies are permitted to make to directors and the disclosure requirements. However as a result, a company may not have to disclose details of a loan which it needed member authorisation to make (and will in any case not need to disclose the name of the director when reporting loans in the notes to the accounts). The breaking of the link also means that different definitions are used in respect of authorisation and disclosure, and that the specific authorisation exemptions are not replicated.

Options

9. Possible options for amending section 413 are as follows-

Option 1: amend only s413(8), and thus to return to the disclosure by way of note to the accounts similar to that which existed under the Companies Act 1985 whereby banks were required to disclose the total amount of loans, the total amount of guarantees and total amount of credits to their directors, even if made on normal commercial terms. This could be achieved by replacing the words "(3)(a) and (4)(b)" with the words "(5)(a) and (c)". There would be no breakdown of this figure for individual directors, nor would they be named.

Option 2: repeal s413(8). This would require banks to publish in their accounts the same level of detail of advances, credits and guarantees as specified for non-banking companies in s.413.

Option 3: require more disclosure by all companies, perhaps more closely aligned to the requirement of sections 197-214 of the 2006 Act, which set out the requirements for the approval by members of loans, quasi-loans and credit transactions with directors? This might involve for example, aligning the terms used, extending the disclosure to persons connected with directors, and to loans made to the directors of any group company.

The consultation document asks for suggestions of other options that the Government should consider.

Costs and benefits

OPTION 1: AMEND S413(8)

Benefits	Costs
<p>This would fulfil the intention of the 2006 Act, which was to continue to exercise the option available to Member States in article 40(7) of the Bank Accounts Directive² to require banks to disclose only aggregate figures for such advances, credits and guarantees. That was the position under the Companies Act 1985. However, because of an incorrect cross-reference, the effect of s413(8) of the 2006 Act as enacted is to require the information for each director (without naming the director), and not an aggregate figure. This would reduce the amount of unnecessary disclosure of what a major clearing bank has told us might add an extra 15 pages to what is currently 300 pages of accounts and thus enable shareholders to focus on what is important. Banks may take a conservative view that the law as currently drafted requires every credit card transaction undertaken by each director to be disclosed.</p> <p>This option could be used as a short term measure to enable the year ended 31 December 2009 annual accounts to be published without many pages of potentially irrelevant disclosure. At the same time the Government could publish draft regulations on any proposals for Option 3.</p>	<p>There would be a reduction in disclosure for banks and the holding companies of credit institutions, but they would still have to disclose the totals for loans, guarantees and advances and they would still be subject to the disclosure requirements such as IAS 24, FRS 8, the FRSSSE, and the Listing Rules, depending on which were applicable to them.</p>

OPTION 2: REPEAL S413(8)

Benefits	Costs
<p>Banks would be treated in the same way as non banking companies in the requirement to disclose the detail of loans, advances and guarantees. Shareholders and other users of accounts would thus receive more information. Shareholders are entitled to this information because of the</p>	<p>Banks will have collected the information already, but there will be significant additional pages of disclosure (see above for advantages of option 1), which will add to complexity and might reduce usefulness of accounts, by focussing users' attention on what is relatively</p>

² Council Directive 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions.

<p>separation of stewardship and ownership in companies. Because of the exemptions given to money lending companies about the need for prior authorisation of such loans to directors in s197 of the Companies Act, members would benefit from being informed about such loans. Money lending companies may be granting loans to directors that they might not be granting to others – if this is the case, shareholders would only find out about this from such disclosure in the accounts.</p>	<p>less important. If they wish to come within the dispensation for moneylending companies, banks are prohibited from lending on non-commercial terms, thus the only loans that would be disclosed would be ones that are at commercial rates.</p>
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OPTION 3: REQUIRE MORE DISCLOSURE

Benefits	Costs
<p>The benefits of this option will vary depending on the additional disclosures that the Government finally decides to require. At this stage it is only possible to discuss the benefits of the broad suggestions raised in the consultation document.</p> <p>Shareholders would benefit from having the related party transactions disclosed.</p> <p>Disclosure such as opening, closing and maximum balances would be more meaningful than the current requirement.</p> <p>Identifying individual directors would enable shareholders to see which directors were receiving loans and of what amount.</p> <p>Any new requirement should be designed to fit well with other existing requirements, for example in accounting standards.</p>	<p>The costs for companies would depend on the extent to which the new requirements exceeded the disclosure requirements to which they are already subject.</p> <p><i>FRSSE</i></p> <p>Those companies qualifying as small under the Companies Act 2006 may use the Financial Reporting Standard for Smaller Entities (FRSSE) to prepare their accounts. The FRSSE (section 15) already requires more extensive disclosure than currently in the Companies Act, including the name of the director or connected person receiving the loan and the opening, closing and maximum balances.</p> <p>Thus for those small companies preparing accounts under the FRSSE, there should be no additional costs.</p> <p><i>IAS 24</i></p> <p>Any company governed by UK law may produce IAS accounts, but these are required only for consolidated accounts of companies whose securities are admitted to trading on an EU regulated market. The objective of IAS 24 (para 1) is to ensure that an entity's financial statements contain the disclosures</p>

necessary to draw attention to the possibility that its financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances with such parties.

IAS 24 requires:

disclosure of the fact of the loan, amount of the loan, even if it was discharged in the year;
categorisation of loans, perhaps by individual director.

IAS 24 applies not only to directors but to key management personnel and to related parties. Accounting experts disagree about how far “key management personnel” stretch beyond directors, and whether individual names are required.

FRS 8

Accounts drawn up under UKGAAP which do not use FRSSE will be subject to FRS8 (Related Party Disclosures). FRS8 has similar requirements to that of IAS 24. UK GAAP will be phased out probably by 2012.

Costs

The additional costs would fall on companies preparing accounts using IAS24 and FRS8, which it is assumed are large and medium companies. Companies granting loans will be record these as part of their accounting records, thus there should be negligible costs related to accounts preparation. There will be a small additional cost of auditing any extra disclosures. Directors of banks who do not wish the detail of their personal loans to be disclosed, might start banking with competitor banks, and obtain their loans from these institutions. This would mean that they would be in less of a position to judge the effectiveness of their own businesses by no longer experiencing a customer relationship their own banks.

SPECIFIC IMPACT TESTS

Competition Assessment

We believe that this proposal will have no significant adverse impact on markets. The costs and benefits are not sufficiently large to affect competition between companies of different sizes.

Small Firms Impact Test

We believe that none of the options will have a significant adverse impact on small firms. Options 1 and 2 impact only on banks. Under Option 3, for those small companies preparing accounts under the FRSSE, there should be no additional costs.

Race Equality, Disability Equality and Gender Equality

We do not believe that there will be an impact on the equality strands as the proposals impact on companies, not on individuals. We have, however, looked at each of the equality impact initial tests individually and are confident that there is no impact.

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	Yes	No
Disability Equality	Yes	No
Gender Equality	Yes	No
Human Rights	No	No
Rural Proofing	No	No

