



The abuse of company incorporation to commit fraud

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Introduction

Limited liability companies are a convenient vehicle for many people to conduct business both domestically and in the international marketplace. They can be beneficial to the economy – stimulating growth, creating employment and rejuvenating local communities.

But can the current regulatory regime for companies – which is already considered ‘light touch’ by some commentators – actually facilitate the commission of financial crime?

We know that fraud is on the increase, yet our understanding of the extent to which limited companies can be used to facilitate fraud is currently incomplete with few statistics available. The abuse of incorporation to commit fraud – for example, through phoenix companies, long firm fraud and fraudulent trading – can have a profoundly negative impact on the UK economy, ripping off suppliers, creditors, customers and the public purse.

We suggest that the opportunities to commit this type of crime can be reduced by addressing the shortcomings of the current system of incorporation, and by introducing new and more stringent requirements for those who operate limited liability companies.

This paper summarises the findings of a roundtable convened by the Fraud Advisory Panel in May 2012 to consider the abuse of incorporation to commit fraud and what can be done to combat it. A series of subsequent discussions with other experts shed further light on the nature of the problem.

Doing business in the UK: The current regulatory regime

The UK is one of the easiest places in the world to do business,¹ and the current Government is committed to encouraging enterprise, reducing unnecessary business regulation, and helping people to set up in business.²

Setting up in business

Companies House (an executive agency of the Department for Business, Innovation and Skills (BIS))³ is responsible for the incorporation and, in some cases, the dissolution of limited companies in the UK, and acts as a central repository for publicly accessible company information.⁴

¹ The World Bank (2012) *Doing business 2012: doing business in a more transparent world*. Available from doingbusiness.org/.

² Department for Business, Innovation and Skills (2012) *About BIS* [online]. Available from bis.gov.uk/about. Also see The World Bank (2012) *Doing business 2012: doing business in a more transparent world*. Available from doingbusiness.org/.

³ Companies House (2012) *About us* [online]. Available from companieshouse.gov.uk/about/functionsHistory.shtml.

⁴ Companies House (2012) *About us* [online]. Available from companieshouse.gov.uk/about/functionsHistory.shtml.

Over 450,000 new companies are incorporated each year; a figure which has been steadily increasing since 2008.⁵ Currently there are almost three million limited companies registered in Great Britain (see table 1).⁶

There are a number of benefits associated with incorporation. The foremost amongst these are the following.

- **Separate legal identity:** the company is a distinct legal entity, separate from the management (directors and company secretary) and its members (shareholders).⁷ This means that the company may enter contracts and sue and be sued on them without reference to the officers of the company or its members.
- **Liability is limited:** incorporation limits the financial liability of company officers and members (to the amount unpaid on their shares) and personal assets are not put at risk. Most private companies issue shares as 'fully paid'. This means that if things go wrong, a member's only loss is the value of the shares and any loans made to the company,⁸ and the directors can rely upon the 'veil of incorporation' (the protection that directors of a company have from limited liability) although this may be lifted in specific circumstances.⁹
- **Ease of incorporation:** setting up a business is a relatively simple process with little 'red tape'. It can be done for as little as £13¹⁰ either directly with Companies House or via a company formation agent (see box 1).¹¹
- **No requirement to disclose the legal or beneficial ownership of the company:** the true identity of owners or directors of the company may be hidden with complete legality behind nominee directors.
- **No minimum capital:** companies may be formed without any capital base, funding or investment.

Applications for incorporation are subject to examination by Companies House which includes ascertaining whether a director is disqualified (it maintains the Disqualified Directors Register)¹² and whether the same company name is already registered with them or includes a sensitive or offensive word or expression.¹³

⁵ Companies House (2012) *Annual report and accounts 2011/12*. Available from companieshouse.gov.uk/about/corporateDocuments/annualReport2011_12.shtml. Also see Companies House (2011) *Statistical tables on companies registration activities 2010/11*. Available from companieshouse.gov.uk/about/companiesRegActivities.shtml.

⁶ Companies House (2012) *Annual report and accounts 2011/12*. Available from companieshouse.gov.uk/about/corporateDocuments/annualReport2011_12.shtml.

⁷ Companies House (2012) *Incorporation and names (GP1). Version 4.6*. Available from companieshouse.gov.uk/about/pdf/gp1.pdf.

⁸ Tutor2U (2012) *Advantages of forming a limited company* [online]. Available from tutor2u.net/business/finance/legal_company_advantages.htm.

⁹ See *Lindsay v O'Loughnane* [2010] EWHC 529 (QB). Available from bailii.org/ew/cases/EWHC/QB/2010/529.html.

¹⁰ Companies House (2012) *Companies House prices* [online]. Available from companieshouse.gov.uk/toolsToHelp/ourPrices.shtml.

¹¹ Companies House (2012) *Start a company* [online]. Available from companieshouse.gov.uk/infoAndGuide/companyRegistration.shtml.

¹² Companies House (2012) *Incorporation and names (GP1). Version 4.6*. Available from companieshouse.gov.uk/about/pdf/gp1.pdf.

¹³ The public can also challenge names that are similar to company names already registered after registration.

Ongoing obligations and compliance

Once incorporated, all companies (even dormant ones) are expected to comply with a number of annual and ad hoc ('event driven') requirements set out in the Companies Act 2006, such as the filing of annual returns and accounts and notifying changes to the registered particulars of the company's officers and its registered address.¹⁴ Failure to do so can be a criminal offence and may also result in automatic civil penalties.¹⁵

Ongoing filings with Companies House are subject to basic checks; no checks are made to verify the accuracy of the information submitted or to prevent the appointment of disqualified directors to existing companies as this is considered a matter for the company itself.

Unfortunately, not all companies are successful, and those that fail can be struck off the register and dissolved.¹⁶ Companies that are no longer in business or in communication with Companies House are dissolved as part of an ongoing enforcement strategy.¹⁷ Directors can also be disqualified by the courts from acting as company directors for a maximum period of 15 years for various acts of misconduct such as involvement in fraudulent activity or trading while insolvent, and their names are then entered onto the Disqualified Directors Register.¹⁸ Once the period of disqualification has ended the individuals' names are removed from the register.

Box 1: company formation agents

Company formation agents act on behalf of their clients to incorporate companies and often offer other services such as registered office addresses. Agents are regulated for anti-money laundering purposes by either HM Revenue & Customs (HMRC) or a recognised supervisory body.¹⁹

Formation agents can voluntarily join the Association of Company Registration Agents (ACRA) which is the only recognised trade association for the sector. Its members comply with a code of professional conduct and account for just over half of all company registrations in the UK.²⁰

¹⁴ Companies House (2012) *Life of a company. Part 1: annual requirement (GP2)*. Available from companieshouse.gov.uk/about/pdf/gp2.pdf. Also see Companies House (2012) *Life of a company. Part 2: event driven filings (GP3)*. Available from companieshouse.gov.uk/about/pdf/gp3.pdf.

¹⁵ Companies House (2012) *Life of a company. Part 1: annual requirement (GP2)*. Available from companieshouse.gov.uk/about/pdf/gp2.pdf. Also see Companies House (2012) *Late filing penalties (GP5)*. Available from companieshouse.gov.uk/about/pdf/gp5.pdf.

¹⁶ Companies House (2012) *Strike off, dissolution and restoration (GP4)*. Available from companieshouse.gov.uk/about/pdf/gp4.pdf.

¹⁷ Communication from Tim Moss (Acting Chief Executive, Companies House).

¹⁸ The Insolvency Service (2012) *Insolvent companies and disqualified directors* [online]. Available from bis.gov.uk/insolvency/Companies/insolvent-companies/what-action-can-be-taken-against-a-director.

¹⁹ Money Laundering Regulations 2007, 3(10). Available from legislation.gov.uk/uksi/2007/2157/contents/made. Also see HM Revenue & Customs (2012) *Trust or company service providers and money laundering regulations* [online]. Available from hmrc.gov.uk/mlr/getstarted/register/tcsp.htm.

²⁰ Association of Company Registration Agents (2012) *Homepage* [online]. Available from acra-uk.org/.

Incorporation as a vehicle for fraud

Companies may be set up for the principal purpose of committing crime, or subsequently lend themselves to being used for that purpose, and the current registration regime is severely limited in its ability to discern the good from the bad. In extreme cases, incorporation is used purely as a front to enable fraud to flourish.

The impact of corporate abuse reverberates throughout the economy and everyone pays the price through higher taxes and the increased cost of purchasing goods and services. Legitimate businesses also lose out having to write off losses as bad debt and bear the brunt of any reputational fallout. The victims are:

- the Exchequer, as a revenue collector
- legitimate businesses, as suppliers, customers, lenders and corporate investors
- individuals, as customers, investors and taxpayers.

The manner in which incorporation can be used by criminals to commit fraud can take many forms, but some of the most common ways that it can be used for nefarious means include the following.

- **Fraudulent trading:**²¹ occurs when a company deliberately carries on business for the purpose of defrauding creditors, often while it is insolvent or being wound up.
- **Long (and short) firm fraud:**²² occurs when criminals set up a company with the intention of defrauding other legitimate businesses. The business trades legitimately for a period of time in order to establish a good reputation and credit history before placing large orders with suppliers and disappearing with the goods. A variation on this is short firm fraud which occurs over a much shorter timeframe.
- **Phoenix company fraud:**²³ occurs when the assets of a failing company are transferred to a new company (the phoenix company). The failed company is then wound up leaving a trail of debts and out-of-pocket creditors behind it. The new company is often the same or similar to the former one but is able to trade with a clean sheet (see box 2).

Companies that are established for entirely fraudulent purposes often try to create the illusion of being more financially secure and reputable than they actually are in order to dupe potential investors, suppliers and customers. This can be facilitated through the filing of fraudulent statutory documents with Companies House, including annual accounts cut and pasted from legitimate company accounts and changes to directors which may involve an element of corporate identity fraud (impersonating another company or hijacking it).²⁴ In response to this, Companies House introduced the

²¹ Serious Fraud Office (2012) *Fraud* [online]. Available from sfo.gov.uk/fraud/what-is-fraud/corporate-fraud/fraudulent-trading.aspx. Also see Action Fraud (2012) *Insolvency-related fraud* [online]. Available from actionfraud.police.uk/fraud-az-insolvency-related-fraud.

²² Action Fraud (2012) *Types of fraud* [online]. Available from actionfraud.police.uk/fraud_protection/long_term_and_short_term_fraud. Also see Fraud Advisory Panel (2009) *Fraud hotspots in smaller businesses. Fraud Facts Issue 4*. Available from fraudadvisorypanel.org/publications.php?c_id=19.

²³ Action Fraud (2012) *Types of fraud* [online]. Available from actionfraud.org.uk/fraud_protection/phoenix_company_fraud.

²⁴ Fraud Advisory Panel (2011) *Corporate identity fraud. Fraud Facts Issue 1* (2nd edition). Available from fraudadvisorypanel.org/publications.php?c_id=19.

Protected Online Filing (PROOF) scheme in 2005²⁵ to prevent unauthorised paper filings with a view to reducing 'a company's vulnerability to fraud',²⁶ but take-up to date has been low with less than half of all registered companies participating in the scheme.²⁷ In addition, its Monitor Service alerts companies whenever specified filings take place against a particular company to enable false filings to be challenged.

Box 2: pre-pack administrations

Pre-pack administrations (and liquidations) are controversial because of their lack of transparency and potential for abuse,²⁸ and because they are seen by some to disadvantage creditors. This issue has recently been subject to reviews and public consultations by the Insolvency Service (although the government decided against legislative change²⁹) and considered as part of a wider select committee inquiry which has yet to report (see 'enforcement').³⁰

The perpetrators

Those who abuse the system of incorporation can be broadly categorised as either the professional (often organised) criminal who establishes a company with the sole purpose of defrauding others; and the accidental fraudster who is often a director under whose supervision the company 'floats' into fraud either through incompetence or financial difficulty.

At one end of the spectrum, the professional fraudster uses the company (and sometimes professional advisers) to legitimise their activities and facilitate their crimes, and to create a barrier between them and possible detection by law enforcement agencies. These individuals are often highly educated, adept at running businesses, and fleet of foot using multiple jurisdictions to cover their tracks. At the other end, the incompetent director often does not understand their legal responsibilities in respect of the company. This distinction has important implications for the development of effective solutions to the problem.

Enforcement

Responsibility for the non-criminal investigation of allegations into corporate abuse falls to the Insolvency Service (a partner organisation of BIS) although many enforcement agencies deal with crimes or regulatory issues generated by companies.

²⁵ Companies House (2012) *PROOF (protected online filing) scheme* [online]. Available companieshouse.gov.uk/infoAndGuide/proofArticle.shtml.

²⁶ Companies House (2012) *Annual report and accounts 2011/12*. Available from companieshouse.gov.uk/about/corporateDocuments/annualReport2011_12.shtml. See page 13.

²⁷ Companies House (2012) *Annual report and accounts 2011/12*. Available from companieshouse.gov.uk/about/corporateDocuments/annualReport2011_12.shtml.

²⁸ House of Commons Business, Innovation and Skills Committee (2012) *The insolvency service (written evidence)* [online]. Available from parliament.uk/business/committees/committees-a-z/commons-select/business-innovation-and-skills/inquiries/parliament-2010/insolvency-service/.

²⁹ The Insolvency Service (26 January 2012). *Written ministerial statement: Edward Davey, Minister for Employment Relations, Consumers and Postal Affairs; Department for Business, Innovation and Skills: pre-packed sales in insolvency*. Available from bis.gov.uk/insolvency/Consultations/PrePack?cat=closedwithresponse.

³⁰ See House of Commons Business, Innovation and Skills Committee (2012) *The insolvency service (written evidence)* [online]. Available from parliament.uk/business/committees/committees-a-z/commons-select/business-innovation-and-skills/inquiries/parliament-2010/insolvency-service/.

Complaints concerning existing companies are reported to the Insolvency Service and handled by its company investigations team which uses powers under the Companies Acts to investigate (usually on a reactive basis) limited companies on a non-criminal basis for serious misconduct, fraud, scams or sharp practice where it is in the public interest to do so.³¹

In 2011/12, 165 investigations were undertaken by the Insolvency Service compared to 3,523 complaints (though a complaint may not always be capable of being investigated under Company Act powers), and 355 winding up orders were obtained.³²

Failed companies can also be investigated by the Insolvency Service. A company that is compulsorily wound up is investigated by the Official Receiver. In other forms of financial failure – administration, voluntary winding up and receivership – the appointed Insolvency Practitioner has an obligation to file a report on the directors' conduct to the Secretary of State (in practice the Insolvency Service) which then considers whether to investigate.

All investigation routes may lead to a range of outcomes including: no further action, director warnings, winding up of company, disqualification of directors, referral for criminal investigation and prosecution (usually to the criminal enforcement team within BIS), or referral to another regulatory authority (such as the Financial Services Authority).³³ In 2011/12, 1,151 undertakings or disqualifications against directors were secured.³⁴

Complaints are often reported to the police. On average each month Companies House refers 44 cases of fraud to law enforcement for investigation.³⁵

There are a number of potential barriers to effective investigation and enforcement action.

- **Focus on criminal outcomes:** fraud is notoriously difficult to prosecute. In some circumstances, the civil justice system and insolvency proceedings can offer a quicker route for victims who have the financial means, and they require a lower evidential burden of proof.
- **Lack of cooperation and coordination:** the diversification of enforcement agencies and a still-pervasive lack of cooperation (and willingness to share information) between agencies often results in orphan cases that no one is prepared to take on.

³¹ The Insolvency Service (2011) *Company investigations: what we do*. Available from bis.gov.uk/insolvency/Publications. Note: this excludes sole traders or partnerships (unless they have limited liability) and companies that do not have a UK business address or have been dissolved. It does include overseas registered companies that are operating in the UK.

³² The Insolvency Service (2012) *The Insolvency Service annual report and accounts 2011–2012*. Available from bis.gov.uk/assets/insolvency/docs/publication-pdfs/ar2011-2012.pdf.

³³ The Insolvency Service (2011) *Company investigations: what we do*. Available from bis.gov.uk/insolvency/Publications.

³⁴ The Insolvency Service (2012) *The Insolvency Service annual report and accounts 2011–2012*. Available from bis.gov.uk/assets/insolvency/docs/publication-pdfs/ar2011-2012.pdf.

³⁵ Companies House (2012) *Annual report and accounts 2011/12*. Available from companieshouse.gov.uk/about/corporateDocuments/annualReport2011_12.shtml. See page 4. Also see Companies House (2012) *About us* [online]. Available from companieshouse.gov.uk/infoAndGuide/reportingFraud.shtml.

- **Insufficient resources:** government cost-cutting measures have reduced the amount of resources available (both manpower and financial) to investigate and prosecute all forms of fraud and financial crime, including corporate abuse.
- **Cross-jurisdictional nature of cases:** fraudsters often use different jurisdictions to their advantage – moving assets, operations and themselves from one country to the next. Some foreign jurisdictions are more helpful than others and investigations can be severely hampered as a result.
- **Lack of enforcement ‘teeth’:** fraudsters usually exploit what they perceive to be the weakest jurisdiction and point in the legal system. Not only is incorporation in the UK simple and cheap, it is also lightly policed. Anecdotal evidence suggests that the veil of incorporation is now being used by some serious criminals (such as drug dealers) to shield their criminal enterprises.
- **Difficulty in successfully prosecuting a corporate offence:** to prove that the company was guilty of an offence involving ‘guilty intent’ it is necessary to prove ‘the acts and state of mind’ of those who represent the directing mind and will of the company.³⁶ This is often impossible to do and has resulted in failed prosecutions (eg for corporate manslaughter).

Table 1: Key statistics for Companies House 2011/12³⁷

Total active companies registered	2.9 million
New companies registered	456,000
Companies dissolved	290,000
Compliance rate for filing accounts	98.9%
Number of fraud cases referred to law enforcement	44 per month

Making the UK more resilient to corporate abuse

The relative ease with which companies can be incorporated in this country is believed to have made the UK particularly vulnerable to the abuse of incorporation to commit fraud. This has prompted some leading commentators to describe the existing company incorporation regime as being ‘little short of a petri dish for incubating fraud’.³⁸

UK-incorporated companies are now often the company of choice for many formation agents and criminals alike. By choosing to incorporate in this country, the company is given an air of respectability coupled with less regulation; Companies House offers a cheap online process with virtually no due diligence. This situation is unlikely to change, at least in the short-term, given the current Government’s programme to reduce the regulatory burden on business.

³⁶ *Tesco Supermarkets Ltd v Natrass* [1972] AC 153.

³⁷ Companies House (2012) *Annual report and accounts 2011/12*. Available from companieshouse.gov.uk/about/corporateDocuments/annualReport2011_12.shtml.

³⁸ Communication from Helen Hatton (Chief Executive, Sator Regulatory Consulting Ltd).

However, there is some good news. Over the last few years the counter-fraud community has become more galvanised, spearheaded in large part by the Government's commitment to making the UK more resilient to fraud which has seen the introduction of a raft of new initiatives including the National Fraud Authority, City of London Police (CoLP) acting as the national lead force for fraud and, more recently, the National Crime Agency (and Economic Crime Command) as well as high-profile investigation and enforcement successes by the Financial Services Authority (FSA) and CoLP in taking down boiler room scams (investment frauds using high-pressure sales techniques).³⁹

Although the situation is improving, experts believe that there is still more that can be done, both immediately and in the longer term (see 'recommendations'), to protect the reputation and integrity of the UK as a place to do business and to act as a global leader in tackling the abuse of incorporation head-on.

Educating directors

UK company directors have a duty to act in good faith to promote the success of the company for the benefit of its members and to exercise reasonable care, skill and due diligence.⁴⁰ Becoming a director is a privilege and it is important that new company directors, as well as those who have been directors for a number of years, are aware of their duties and liabilities under the Companies Act 2006.

Although Companies House publicises directors' obligations through a range of media – on its website, directors' seminars, focus groups, formation agents, social media, etc – it does not send out (in either electronic or hard-copy format) material to new or existing directors upon appointment.

For larger organisations this type of information is often made available through their membership (or that of their senior staff) of relevant professional and/or trade bodies. But this is not always the case for smaller businesses, particularly those that have grown into companies from more modest sole trader roots, meaning that some may unwittingly fall into misconduct and corporate abuse through director incompetence, negligence and/or ignorance rather than intentional malfeasance.

Better director education could easily address this issue. Therefore, we recommend that all directors of new companies, and new directors of existing companies, receive simple and practical electronic information from Companies House on their roles, responsibilities and liabilities as part of the appointment process. This could be provided with relative ease and at low cost. Similar schemes already operate elsewhere. For example, the Charity Commission sends trustees of newly registered charities a welcome booklet ('The essential trustee: what you need to know') to remind them of their duties, and this is also made available online.⁴¹

³⁹ Fraud Advisory Panel (2010) *Boiler room fraud. Fraud Facts Issue 6*. Available from fraudadvisorypanel.org/pdf_show_150.pdf.

⁴⁰ Companies Act 2006. Available from legislation.gov.uk/ukpga/2006/46/contents.

⁴¹ Charity Commission (2011) *Registering as a charity (CC21)* [online]. Available from charity-commission.gov.uk/Publications/cc21.aspx#45. Charity Commission (2008) *The essential trustee: what you need to know*. Available from charity-commission.gov.uk/Charity_requirements_guidance/Charity_essentials/The_essential_trustee.aspx.

Legitimate businesses also need to be confident that the organisations they do business with are honest and reputable. Businesses, particularly smaller ones, could benefit from a national campaign to raise awareness of the practical due diligence checks that they should perform on new suppliers and customers to better protect themselves against fraud.

Organisations with expertise in this area could be brought together under the auspices of the national fraud strategy 'fighting fraud together' to collaborate on a joint initiative to produce a single authoritative free resource that can be cascaded to businesses through a variety of existing networks. Participants could include (but are not limited to): Fraud Advisory Panel, Action Fraud (or the National Fraud Authority), Companies House, Insolvency Service, and the Federation of Small Businesses.

Researching the problem

Recent developments in the wider law enforcement arena, such as the establishment of the National Fraud Intelligence Bureau and National Crime Agency, and current exercises to map professional enablers and corporate UK will build a better national fraud intelligence picture over time. But in the meantime, our current understanding about the incidence of corporate abuse, and in particular the extent to which incorporation is used specifically and purposefully as a vehicle to commit fraud – by serious organised crime groups and/or with the involvement of professionals – is limited and needs to be improved. The solution is twofold.

- Include company service providers (such as company formation agents and those offering virtual or serviced offices) within the scope of existing exercises to map professional enablers to determine whether there is a case for better regulation.
- Commission research into the nature and extent of corporate abuse and its impact upon victims, particularly legitimate businesses, and its cost to the wider UK economy. The latter could be conducted as part of the National Fraud Authority's 'Annual Fraud Indicator' exercise.

It is worth noting that at the moment there is no general obligation resting on companies to report fraud to UK law enforcement agencies (with the exception of money laundering offences) and opinion is divided as to whether there should be.⁴² Companies can, however, make voluntary reports to the police, Action Fraud or the Serious Fraud Office, and should be encouraged to report victimisation more.

Improving due diligence checks on company directors

Greater safeguards are required to protect legitimate businesses, investors and the general public and to stop rogue directors setting up companies in the first place. This could be achieved in large part through Companies House performing a more robust gatekeeper function.

As a minimum, we believe that there should be an obligation on Companies House to perform more rigorous checks, particularly against the Disqualified Directors Register, when processing new applications for incorporation and new director

⁴² Fraud Advisory Panel (2010) *Fraud reporting: a shared responsibility*. Available from fraudadvisorypanel.org/publications.php?c_id=24.

appointments to ensure that directors with a 'bad' history are unable to set up new limited companies or to become directors of existing ones. The current mechanisms in place to do this are flimsy at best.

Enquiries should also be made as to the beneficial ownership of the company and whether the shareholder is a nominee. Consideration should be given to placing this information on the public register to improve corporate transparency. Nominee directorships should not be permitted and the identity and residential addresses of directors should be verified before being registered. Smart fraudsters may use innocent middle men to act as the legal or beneficial owner of a business and take an option which can later be exercised to take control of the business. The risks of acting as a nominee could be flagged on appointment of director forms.

In the longer term, and once the impact of corporate abuse upon the economy is better known, consideration needs to be given to introducing new obligations on prospective directors to demonstrate that they are of good character. For example, to:

- provide proof of identity and creditworthiness;
- pass a fit and proper person test;
- disclose details (and provide evidence) of previous directorships, disqualifications, outstanding CCJs and unspent criminal convictions.

Such measures are likely to act as both a preventative measure and deterrent to would-be fraudsters.

Exemplars already exist both here and abroad. For example, before a company can be incorporated in Jersey the following checks must be performed: WorldCheck, Schengen Information System (SIS), credit ratings, and Disqualified Directors Register.

In the UK, the Land Registry (also a public register of information) has responded to the growing threat of property fraud by introducing requirements on applicants to provide evidence of their identity which can then be verified;⁴³ the FSA (which regulates the financial services industry) has a fit and proper test for approved persons which takes into consideration the person's honesty, integrity and reputation, competence and capability, and financial soundness;⁴⁴ and many employers now require credit checks and disclosure of unspent criminal convictions for positions of trust (eg certain financial roles).⁴⁵ Costs of administering these measures could be offset by the applicants themselves.

⁴³ See the Land Registry website, landregistry.gov.uk.

⁴⁴ Financial Services Authority (2012) *FSA handbook* [online]. Available from fsahandbook.info/FSA/html/handbook/FIT/1. See FIT 1.3.1 Release 131 November 2012.

⁴⁵ See Fraud Advisory Panel (2011) *Pre-employment screening. Fraud Facts Issue 3* (2nd edition). Available from fraudadvisorypanel.org/pdf_show_153.pdf.

Introducing better regulation of company formation agents and virtual offices

Virtual and serviced offices can provide a cost-effective solution for many businesses that want to present a professional and reputable image to their customers and suppliers. But this also makes them an attractive proposition for criminals who can use them to legitimise their activities.

Even though the larger and more reputable company service providers are registered with HMRC for anti-money laundering purposes, many are believed to have inadequate policies and procedures in place to prevent abuse; they do not meet requirements to check directors, shareholders and beneficial owners; and they are unlikely to come under scrutiny from HMRC or be subject to enforcement action.

Recent international research into the formation of shell companies found that overall almost half of company service providers did not ask for proper customer identification, with 22% asking for none at all. More worryingly, it found that those selling shell companies in the UK are less likely to comply with identity rules than providers in many other countries, including tax havens such as Jersey and the Cayman Islands.⁴⁶

It is therefore somewhat unsurprising that company formation agents and virtual offices have been implicated in a number of corporate abuse cases. Other jurisdictions (such as Jersey) do more, and these should be examined as models of best practice to determine how to safeguard the sector here against abuse.

Introducing meaningful disqualification

A complete review of the current disqualification regime needs to be conducted to determine whether and how improvements could be made. It should examine the following.

- Greater enforcement of disqualification orders and undertakings using a combination of proactive (compliance monitoring and periodic checks on disqualified directors to ensure that they are not acting as directors or shadow directors) and reactive (responding to complaints about breaches of disqualification orders and undertakings) activities.
- The introduction of indefinite disqualification orders for directors who are repeatedly shown to be unfit to run companies and/or who persistently set up new companies for nefarious purposes. This could be based on a 'three strikes and you are out' model where the onus is placed on the individual to prove that they are fit to act in the capacity of a company director.
- The establishment of a suitable mechanism to allow official agencies and specified others (such as credit reference agencies) to check whether individuals have been repeatedly disqualified from acting as a director.

⁴⁶ Findley, M., Nielson, D., and Sharman, J. (2012) *Global shell games: testing money launderers' and terrorist financiers' access to shell companies*. Available from griffith.edu.au/_data/assets/pdf_file/0008/454625/Oct2012-Global-Shell-Games.Media-Summary.10Oct12.pdf

- Whether the investigation and enforcement regime dealing with these issues is sufficiently funded and resourced to protect the public from unfit directors and corporate abuse.

It is also recommended that access to the Disqualified Directors Register be more prominently displayed on the Companies House website.

Exploring other options in the long term

In the longer term, consideration should be given to the following.

- New compulsory powers and additional resources to enable the Insolvency Service to investigate on the basis of an Insolvency Practitioner's report.
- Review of the law on corporate offences involving guilty intent. The law in relation to corporate manslaughter as a result of gross negligence has now been made much more certain by the Corporate Manslaughter and Corporate Homicide Act 2007, but the difficulties in proving the 'directing mind and will' of a company in relation to financial crime still exists.

Recommendations

In the short term

- Increase the visibility of the Disqualified Directors Register on the Companies House website (eg on the home page).
- Introduce new minimum due diligence checks at Companies House on all new directors to existing companies against the Disqualified Directors Register.
- Introduce an awareness campaign to encourage more businesses to voluntarily report victimisation to Action Fraud and/or law enforcement.
- Require Companies House to send simple and concise guidance to all directors of new companies on their duties and liabilities as part of the registration process and to make new directors of existing companies more aware that this information is available online (eg dedicated email notifying them of this).
- Establish a cross-sector working group to produce due diligence guidance on 'Do you know who you are doing business with?' to help organisations to better self-protect against fraud arising from corporate abuse.

In the medium term

- Research the nature, extent and impact of corporate abuse on victims and the estimated cost to the UK economy.
- Review the current disqualification regime to determine whether and how it could be improved.
- Require HMRC to better monitor company service providers to ensure compliance with customer due diligence measures and other anti-money laundering provisions.

In the longer term

- Examine best practice from overseas jurisdictions (such as Jersey) to prevent the exploitation of virtual and serviced offices and how these principles could be applied in the UK.
- Consider additional resourcing for the Insolvency Service as well as the introduction of compulsory powers to enable them to investigate directors on the basis of an Insolvency Practitioner's report.
- Introduce a fit and proper persons test for all new company directors to confirm their identity and demonstrate their good character.
- Require Companies House to use data-mining software to look for cut-and-pasted financial reports, and for directors (and other company officers) who have been convicted of dishonesty offences in the past (or otherwise 'marked' by police and other law enforcement authorities) and/or who appear on the Disqualified Directors Register. New minimum requirements for documents that are electronically filed will need to be introduced to enable data mining to be carried out.
- Review the law on corporate crimes, particularly financial crimes, involving guilty intent.

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