This is the text of a speech delivered by Business Secretary Vince Cable in July 2013.

Trust: why it matters

Trust is a key element of every commercial transaction, from the simplest purchase – buying milk from the local shop, say – to the most complex multi-billion pound deal. Having confidence that a product is fresh or that a company's accounts are true and accurate – there is no fundamental difference. A buyer on eBay waiting for a digital camera to arrive from Hong Kong is in essentially the same position as the medieval merchant who purchased silk from Samarkand.

These statements may seem obvious, but we neglect at our peril the extent to which trust is precarious, even in such a well-organised, historically rooted and stable society as our own. Our society functions on the basis that we can trust strangers with our savings, with the purchase of a house, with safely ferrying us from one place to another by bus, train or plane. We feel comfortably removed from the Middle Ages, when food adulteration was sufficiently feared that suspected practitioners faced appalling torture; so too from emerging economies where water-diluted milk, contaminated cooking oil and toxic spirits from home distilleries are daily hazards. Even so, our food chain has recently confronted by alarms over BSE, foot and mouth and the horsemeat scandal.

Until recently, banks were trusted institutions, and large-scale financial fraud meant colourful historical episodes like the South Sea Bubble or cases of anarcho-capitalism like post-Communist Russia. No longer. Trust in these institutions has been seriously undermined by the first major bank run for 150 years; the collapse of leading banks; a seemingly endless succession of mis-selling and price-rigging scandals; and accusations of greed and unethical behaviour against leading figures in the industry.

This experience leads to the question: how do we create, or restore, trust in market transactions? We can no longer rely on the close bonds of family, the proximity of village life, the camaraderie of the regiment or the old school tie. We rely instead on businesses' enlightened self interest in maintaining their brand value and reputation, or an industry's collective interest in self regulation. As a result, we are able to assume that cowboy builders and other assorted rogue traders are untypical.

Yet trust only goes so far. Just as the decline in the status of marriage has

spawned pre-nuptial agreements, big commercial deals have created a goldmine for lawyers. In the US especially, tort costs have become a major business expense, which are usually passed on to consumers. The more complex and long-term the deal, the less the reliance on trust and the greater the reliance on legal protections – with associated transaction costs. These problems apply as well at the interface between the public and private sectors, where speedy decision making is constantly under threat from judicial review.

Trust and regulation

Lack of trust and the costs of tort have also led to a big increase in statutory regulation. The cost of regulation has become a major issue in itself, particularly for small business. But while some regulation is excessively complex and burdensome, it is important not to confuse the symptom – red tape, with the underlying problem – lack of trust.

In the financial sector, an almost total collapse of trust has led to a plethora of new national, European and global regulations on banks and other intermediaries. There have been enormous consequences, some unintended. Some say, for instance, that the tough capital requirements on banks have contributed to a reduction in lending and greater aversion to risk, with damaging consequences for business activity, growth and living standards. But no one now seriously proposes that financiers can be trusted to operate in areas of systemic risk or serve retail customers without such regulation.

How, then, can companies minimise recourse to litigation and statutory regulation? One key area is corporate governance, through which companies can establish a reputation for transparency and fair dealing – with their investors primarily, but also with customers, employees and society at large.

Good governance

In the UK, we have a history of good corporate governance. The UK Corporate Governance Code and Stewardship Code provide a model which many countries have adopted. From Sir Adrian Cadbury's report in 1992, through Greenbury, Hampel, Higgs and subsequent reviews, we've continued to examine the governance landscape. Under the Coalition, that has been taken forward through the Kay review, whose recommendations we are now implementing, and through the important work of Lord Davies on improving the diversity of boardrooms. Our changes to narrative reporting will encourage companies to focus on the issues that really matter, while our executive pay reforms, which come into force in October, have been widely welcomed.

Shareholders will soon have greater power to hold companies to account through binding votes. There will be increased clarity over who's paid what – leading, I hope, to better engagement between companies and

shareholders, clearer links between pay and performance and far fewer stories lamenting rewards for failure.
More generally, the vast majority of UK companies abide by the law. But it is a fact that the company structure can be misused to facilitate criminal activities, including money laundering, tax evasion and terrorist financing. Even where the law is observed to the letter, the spirit may not be. That is the issue at the heart of the current debate around corporate tax, where we have seen company brands tarnished by accusations of unethical behaviour.
Today, I want to explain how we can tackle some of these problems.

Beneficial ownership

First, ownership. We know who legally owns UK companies. Their names appear on each company's share register, which is publicly available. But to establish who really owns and controls a company, we must identify its beneficial owners too – in other words, the individuals with ultimate ownership or control. They're not always one and the same.
There is currently no requirement for companies to hold information on their beneficial owners as a matter of course. This means the beneficial owners can conceal their identity and their interest in a company, for example by hiding behind a sham director or nominee shareholder. They can use the company to facilitate a whole range of questionable activities, and it can be very difficult for law enforcement or tax authorities to prove any link to such individuals.
There is a clear correlation between illicit activity and lack of transparency in the ownership and control of companies. For example, a 2011 report co-authored by the World Bank found that, of 213 grand corruption cases investigated, 150 involved the use of at least one corporate vehicle to conceal beneficial ownership and the true origins of funds. In these 150 cases, the total proceeds of corruption were well over $50 billion.
Increased transparency of company ownership and control will make it harder for criminals to operate and expose bad practice. And where abuse does occur, greater transparency will make the job easier for prosecuting authorities. In addition, the Sentencing Council is currently consulting on guidelines to toughen up sentences for fraud, bribery and money laundering. Firm action in this area will improve the overall investment environment – shining a light on companies that don't play by the rules, and levelling the playing field for legitimate investors.
At the G8 summit last month, the UK committed to taking action to enhance corporate transparency, including the creation of a central registry of company beneficial ownership information, maintained by Companies House.
There is a strong argument for a public, open registry to improve

transparency and trust. But this is not without controversy and we need understand the range of views. Today, I have published a discussion paper covering how we intend to implement our commitment to a central register, seeking input from the business community on what information should be disclosed, when and how.
Similarly, we are looking at how companies disclose information on any subsidiaries. Companies House is currently checking the position of all of the FTSE 350 companies, and will report back to me by the end of this month, the first step towards permanent monitoring in this area. We began reviewing subsidiary reporting in 2011, since when Companies House has improved online guidance to companies and cracked down on repeat offenders. There may, however, be more we can do develop a simpler system – making it easier both to access information and check compliance.

Abuse of corporate structures

I also propose to take action to limit the scope for misuse of three specific corporate structures: bearer shares, nominee directors and corporate directors.
First, bearer shares provide a way for individuals to avoid having their identity revealed on a company's share register. There are people out there who set up shell companies issuing bearer shares precisely because they make ownership so opaque, thereby enabling such share owners to conceal the location of illicit gains.
Appointing and registering nominee directors with Companies House can serve similar ends. Legitimate practice here could be to provide a parent company with representation on the board of a subsidiary. But, in some cases, individuals rent their names to companies in return for payment, before signing legal documents handing over all management responsibility. There are around 350 individuals who each hold more than 100 directorships in the UK, and even cases of people holding up to 1,000.
The paper also examines the issue of companies being directors. Again, there are some legitimate commercial reasons for doing so, albeit limited. But those intent on abuse will create complex corporate ownership structures crossing numerous jurisdictions, thereby obscuring the identity of beneficial owners. We have cases, for example, where dormant companies appear to be acting as corporate directors. It is doubtful whether a dormant company, which is not paying its staff or conducting any business transactions, could ever fulfil its statutory directors' duties.
As part of this work, the government and others responsible for tackling money laundering will be reviewing the regulation of providers who help clients to set up companies, and can therefore be complicit in facilitating corporate smoke and mirrors.

Directors and corporate abuse

When cases of corporate abuse or improper or unfit management are uncovered, they must be tackled in a robust and timely fashion. Knowing that we have an effective system for identifying and dealing with misconduct is essential to creating an atmosphere in which honest entrepreneurs are willing to invest, because they're not at a disadvantage compared to those who flout the rules.

Each year around 1,200 directors of insolvent companies are disqualified, and around 90 are prosecuted for criminal behaviour related to the management of a company. Since 2010, more than 700 companies have been wound up in the public interest, 314 of them in circumstances where there has been a lack of transparency regarding their formation, ownership or the veracity of documents filed with Companies House.

Yet, with people apparently responsible for major corporate failures seemingly going unpunished, particularly at the banks, the public has been questioning the adequacy of our disqualification system. This has been brought out most clearly by the analysis of the Parliamentary Commission on Banking Standards, which rightly highlighted specific flaws in the accountability mechanisms for banks. The government has accepted all of the Commission's major recommendations in this respect, including the creation of a new criminal offence of reckless misconduct.

Today's paper takes another step forward in implementing them, asking whether bank directors' duties need to be changed and whether we should improve the way we tackle unacceptable conduct by company directors. For example, should the courts, when considering whether to disqualify a director, have more regard to material breaches of sectoral regulations such as those in financial services and for the societal impact of directors' actions?

Disqualification and failure

I often hear concerns, meanwhile, that directors involved in repeated commercial failures are too easily able to start afresh at another company. We do not wish to punish honest failure. Some of the best entrepreneurs have failures to their name, and that is a necessary corollary of risk taking. But we need to distinguish this from the rogues who use 'phoenix companies' to deceive customers. Requiring disqualified directors to undertake some form of education before they can go on to run another business is an option here. We might also allow the courts to make financial awards against directors they are disqualifying to compensate creditors who have suffered as a result of their actions. This would hit directors where it hurts and provide more direct accountability to those affected by misconduct.

And where directors have been disqualified in another country or convicted of a crime associated with managing a company overseas, there is a legitimate question over whether they should be allowed to be a

director in the UK.

I recognise that these robust powers should only be used in appropriate cases, so that honest directors need not fear sanctions where they have acted in good faith. Many companies fail for genuine reasons, as I've already noted, and failure in itself is not an indication of misconduct.

Insolvency practitioners

To reinforce that message, we are also taking steps to improve trust in the professionals who deal with businesses when they go insolvent. Concerns have been raised, for instance, about the fees charged by insolvency practitioners (IPs). According to the OFT, every year £5 billion of liquidated assets in corporate insolvency produces around £1 billion in IP fees, with £4 billion distributed to creditors. Large, prolonged liquidations have generated understandable concern about the benefit extracted by the liquidators at the expense of others.

An independent review of IP fees, conducted by Elaine Kempson, Emeritus Professor from Bristol University, has now concluded and we will be responding shortly on what steps might be taken to help unsecured creditors, or debtors, exert more effective control on fees.

Meanwhile, we have recently strengthened the complaints procedure for anyone unhappy with the actions of an IP. There is a veritable jungle of self-regulatory confusion, with as many as seven professional bodies involved. Unless we tackle these issues now, they potential for scandal will remain.

Pre-packs

But perhaps the major issue here surrounds the use of pre-pack administrations.

A pre-pack occurs where negotiations for the sale of a company's business and assets are undertaken prior to administration, and the sale is executed upon the appointment of the administrator or very shortly thereafter. Pre-packs are not specifically provided for in insolvency legislation, but have become a common tool for rescuing business. Used in the right way, they enable a quick sale – reducing the likelihood of job and contract losses, and improving outcomes for creditors.

At the same time, though, the pre-pack process lacks transparency. Problems have arisen where businesses appear to have been sold at under value, especially to a previous owner or connected party, with no open market valuation. There is often a lack of involvement for unsecured creditors, who are only informed of the deal after it has taken place. And pre-packs can provide an unfair market advantage by allowing the new company to leave behind its unwanted debts, causing longer-term economic harm by allowing inefficient businesses to carry on trading.

New measures (which creditors have helped to frame) will shortly be in place to strengthen what creditors are told and how quickly they receive

information. This is a welcome step but we need to look more closely at whether pre-packs strike the right balance between retaining a useful restructuring tool and ensuring there is no scope for abuse. Today I can announce an independent review of pre-packs, led by regulation expert Teresa Graham, who will look at all these issues. It will report back with initial findings before the end of the year.

Conclusion: trust and transparency

The government, then, is determined to enhance the climate of trust in which UK business operates – and we want to do so with the backing of the business community, to ensure that we strike an appropriate balance. That's why we successfully pushed for changes to the EU's Transparency Directive, allowing us to get rid of mandatory quarterly reporting. There is now widespread agreement that, as John Kay concluded, rigid quarterly reporting requirements are a disproportionate burden on companies. They promote excessive focus on short-term results by company directors, investors and market intermediaries.

Transparency is not about pressing for more and more information, but about providing clear, timely and accurate information that helps investors, and others, understand a company and its ability to deliver long-term returns. Alongside our reforms to narrative reporting, dispensing with mandatory quarterly reporting will encourage meaningful dialogue between shareholders and companies, so that investors trust directors to make long-term strategic decisions.

So I hope that the proposals I've outlined today will provoke a constructive debate about how we bring about a transparent and trustworthy business environment where companies and individuals can operate and invest with confidence.

According to the latest Ipsos MORI Veracity Index, only 34% of UK adults 'generally trust business leaders to tell the truth'. It is some comfort, albeit scant, to business that politicians perform even worse in their race to the bottom with bankers. So, there's a job to do here. Let's get on with it.