

ne government has abandoned a new law that would have

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The Tory government has backtracked on another of its promises today. I accept that for most people, the abandonment of a commitment to enhance corporate disclosures is not a big deal, but it matters.

Let me take just one example. One of the commitments to change corporate disclosure that was announced only nine months ago was to require that large companies should disclose the level of distributable profits that they have in their accounts. Right now they only have to disclose the full value of their reserves. The two are not the same thing.

Reserves represent the surpluses a company has generated as a result of its activities. They come in two forms. The first is realised reserves. These are the reserves generated by profitable trading. They will turn into available cash. It is legal to pay dividends out of these reserves because the company has earned the means to do so. Its creditors are not compromised as a result.

The other form of reserves is unrealised reserves. Most of these arise because of the revaluation of property and other assets owned by a group of companies. There are other ways to generate them, but revaluing a building bought for, say £10 million that is now worth, say, £50 million is the easiest way most companies have to boost the size of their balance sheet by £40 million (give or take a deferred tax provision for any tax due if the property was ever sold for that sum).

Unrealised reserves are not wrong: they can be used to provide a useful indicator of the real value of assets that a business owns when undertaking its business. Recognising these gains is one way of mounting a defence against asset-stripping takeovers. However, there is no way on earth that they give rise to profits capable of being paid out to shareholders. They do not generate cash. As a result, if dividends are paid out of them, the companies making those payments have to borrow the cash to do so. The result is that such dividend payments might over-stretch the company, leaving it in excessive debt and ultimately threatening its survival.

That is why paying dividends out of unrealised reserves are illegal. But because companies did not have to disclose the split in their reserves no one knew who was breaking the law, or not.

This confusion also creates the situation where companies manipulate their reserves to make such payments. I have [written a paper on this issue](#). It was submitted to the Department for Business, Energy & Industrial Strategy (as was). I rather hoped it informed the announced requirement that the split between realised and unrealised reserves. In case of any company having doubt about how to work out the difference between the two (which we know some claimed they did not know) Adam Leaver and I wrote a paper on how a company might prudently [estimate its realised reserves](#). That also went to BEIS. It was really not hard to do. However, it would have prevented fraud and the excessive payment of dividends to boost executive rewards.

And now the government [has announced it has backtracked](#) on this and other measures, including on green reporting, just nine months after it said changes were going to be legislated. Businesses did not, apparently, like the accountability that such measures demanded of them, so they will not be delivered.

As a result, the abuse will go on. And as a matter of fact, most larger UK companies do pay out more by way of dividends than they can afford. [I have researched that, too](#). In many cases, the overpayments are dramatic. Of course, that is why businesses did not want this.

But, this simple fact also answers [the question posed by Martin Wolf in the FT](#) at the weekend, which was why UK pension funds have abandoned investing in UK equities or shares. The answer is simple and threefold.

First, almost all of them are in long-term decline because they are overpaying dividends.

Second, they are doing this to reward their executives and not their shareholders so rational shareholders should abandon them.

Third, because there is insufficient information to be sure where the risk of overpayment is, it is rational to abandon the market as a whole.

The disclosure of realised reserves would have overcome this problem and so would have boosted the fortunes of decent UK companies. But the government did not want that, and so it has abandoned the change.

In that one paragraph, I summarise the whole bankrupt philosophy of this supposedly pro-market but actually pro-exploitation government.