

Beneficial Ownership of Companies– IPA Submission

Increasing Transparency of the Beneficial Ownership of Companies

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Dear Minister O’Dwyer

Increasing Transparency of the Beneficial Ownership of Companies

Introductory comments

The Institute of Public Accountants (the IPA) is delighted to provide commentary on the current consultation paper: *Increasing Transparency of the Beneficial Ownership of Companies* (hereafter “BOC”)

The IPA is a professional accounting body with members that are recognised for their practical, hands-on skills and broad understanding of the total business environment. Representing a membership of more than 35,000 individuals in Australia and in more than 80 countries, our members and student members are working across a broad range of professional employment and practice, including; industry, commerce, government, academia and private practice. More than 75 per cent of our members work in or with small business and SMEs and are recognised as the trusted advisers to these sectors.

The IPA at the outset commends the government for taking the initiative to consult on this issue. Greater transparency will not only ensure the ability to assist with law enforcement, but would also enhance the amount and quality of information available for research on how corporate structures come to be and operate in Australia and elsewhere. Researchers working within the IPA-Deakin University SME Research Centre have found that the absence of various disclosures related to individuals who hold beneficial interests in companies, has made it difficult, if not impossible, for them to piece together a complete picture of the size, scope

and operations of a company or a conglomerate. Moreover, they argue that it is extremely difficult to trace ownership and inter-locking directorships, which is important for both compliance with relevant laws, and for research. Indeed, prominent legal and finance researchers who have investigated ownership structures of companies in other jurisdictions have long argued that, until the beneficial owners of securities can be properly established, it would be difficult to determine what ownership disclosures are required under securities legislation and by whom (e.g., Feldman and Teberg, 1966; La Porta, Lopez-de-Silanes and Schleifer, 2006, 1999; Claessens, Djankov, Fan and Lang, 2002)ⁱ. We encourage the government to expedite reforms in this area to improve both the success of law enforcement and also the opportunities for thorough, comprehensive and insightful research.

We note at the outset that the information collected should at all times be accessible by other agencies involved in complex investigations. This may include investigations by the Australian Taxation Office into corporate structuring used in part to evade taxation. All steps must be taken to ensure the technology used to develop and store the proposed register of ownership is able to be accessed easily by investigators in various departments across government agencies.

It is, moreover, important that any registers that are established as a result of the current consultation process are freely available. The current registers maintained by the corporate regulator, the Australian Securities and Investments Commission (ASIC), can only be accessed if users of this information are able to pay the prescribed fee set by the Commission. This makes access to information expensive, and in some cases difficult, for users to obtain all of the information they may require when they wish to identify the parties who have ownership of an entity. This also suggests that the Australian Securities and Investments Commission Act (2001) would need to be amended to enable users to have free access to ownership-related information.

This submission focuses on areas of the discussion paper of specific interest to the IPA and the IPA-Deakin SME Research Centre. We would be pleased to provide any additional remarks on request.

Complete transparency an essential trade-off for the ‘legal person’

The Corporations Act 2001 provides the opportunity for an individual or group of individuals to create an artificial person, a company that is able to enter into contracts and debt. These privileges conferred by law should at all times come with a requirement that all owners of an interest in an entity, no matter how small or large, are disclosed on a company register that

is accessible to the public. The rights that an entity are provided under law come with a range of responsibilities. One of these should always be full and frank disclosure of those that hold beneficial interests.

This is critical to ensure that business structures are transparent and that investigators and researchers are able to see the linkages between owners of entities more clearly. Such disclosures will provide the necessary details for people in law enforcement seeking to ensure that illegal activities such as tax evasion, money laundering, bribery, corruption and financing activities not in the public interest are detected. As indicated in Blue (1975)ⁱⁱ and Muniandy, Tanewski, and Johl (2016)ⁱⁱⁱ, secrecy is often the primary purpose behind a non-beneficial holding, such that a beneficiary's relationship to a particular nominee company is less apparent. In this sense, it is unclear whether the ownership is for legitimate or illegitimate purposes. While the legitimate nominee shareholding "*should be preserved, full disclosure of the beneficial ownership of all voting shares should be required, both in the general interest of the community, and to discourage illegitimate purposes*" (Blue, p205).

By knowing the identity of beneficial owners, authorities are more readily able to assess whether laws related to company acquisitions have been breached. Such laws include, but may not be limited to, the 20% ownership threshold as stipulated in Chapter 6 of the Corporations Act (takeover provisions), or whether the 3% creeping acquisition clause has been exceeded (also in the takeover provisions), or whether an associate who has a relevant interest is linked to a bidding firm in a takeover offer.

The ability to link directors to other companies as well as a range of related parties is critical for both corporate investigations and research so as to determine whether these links are problematic either legally or ethically. In this sense, the IPA commends the government for having the foresight to consider reforms which would make share ownership more transparent. Moreover, we believe it is important for the government to be in-step with similar initiatives in other jurisdictions such as the UK^{iv} and the US, and the suggested initiatives in the BOC consultation paper would go a long way in providing consistency in beneficial ownership disclosures across major jurisdictions. In turn, this would have a significant effect in preventing global misconduct through fraud, money laundering, tax evasion, the use of finance for terrorist causes, drug trafficking and other similar activities.

It is noted that currently fees apply to enable access to various registers either on the database of the corporate regulator or through an information broker. Searches of company records should be made free of charge in the same way as searches of companies are freely available on the web site of the Securities and Exchange Commission^v in the United States. This would ensure that the average person would be in a position to search without having

the imposition of a fee being a barrier to entry for those wishing to understand a company with which they may be engaged either as a supplier, customer or employee. We argue that this initiative would be a practical implementation of an aspect of the reporting entity concept that was established in the Statements of Accounting Concepts developed during the 1980s and 1990s (which now forms part of the AASB's current Conceptual Framework for the Preparation of Presentation of Financial Reports).

The underlying philosophy of the Conceptual Framework includes the need to provide relevant information to users about the reporting entity, which is useful for making and evaluating decisions about the allocation of scarce resources. When financial reports meet this objective they also are a means by which management and governing bodies discharge their accountability to those users financial information. There are two further related concepts that are important in the provision of such information, which would be greatly enhanced if there are further disclosures of the beneficial ownership of shares. Firstly, the need for financial information to be prepared at 'arm's length' i.e., independently and without bias. Knowing the identity of the ownership of companies would give users some assurance that financial reports have been prepared without bias and not toward any particular individual or group of individuals. Moreover, the reporting entity may not simply be an individual entity, but a series of related entities that, when aggregated, could form a group, otherwise known as an 'economic entity'. The concepts of control and significant influence embodied within the Conceptual Framework provide substantial guidance on which entities should be included within an economic entity, for the purposes of preparing consolidated financial statements (sometimes referred to as group accounts). Consolidated financial statements would thus reflect the performance and financial stability of the economic entity (rather than for individual entities), which would provide invaluable information for users of financial statements, and indeed a host of regulatory agencies. Accordingly, we believe that greater disclosures relating to the beneficial ownership of shares would greatly assist this cause. Particularly in determining whether entities have control or significant influence of other entities, or conversely, whether the entity itself is controlled or is significantly influence by other entities. This knowledge would also further assist in assessing whether the financial reports have been prepared at arm's length.

Exemptions for listed Companies

Our starting position on the issue of exemptions is similar to the perspective taken in the UK, where listed companies on the London Stock Exchange (main board) are already required to comply with stringent provisions relating to beneficial ownership. Accordingly, the UK

consultation paper on reforms for greater transparency argues that additional beneficial ownership information for listed companies will not provide any further value. This approach is similar to the regime that operates in Australia. For example, the relevant interests and substantial holdings provisions within the Corporation Act^{vi}, the Notification of Directors interests in securities^{vii}, both in the Corporations Act and the Australian Securities Exchange Listing Rules. There are also requirements within accounting standards, such as for example, Related Party Disclosures AASB124 and Disclosure of Interests in Other Entities AASB12.

These requirements, however, will not apply to every entity because of the various thresholds that are in place in the Corporations Act. Despite these requirements, however, we believe there might be a strong case for even greater transparency, requiring beneficial ownership information to be disclosed by all Australian companies. For example, for shareholdings less than 5%, when aggregated with other relevant interests including those held by associates, might yield important information, for instance, whether ownership thresholds within the Corporations Act have been breached. We further argue that there are significant advantages in placing full ownership details on the public register, allowing investors, regulators, researchers and the general public access to have a better understanding of who owns and controls companies.

In respect to the timing of the availability of information, it is our view that the existing provisions within the Corporations Act are satisfactory.

Beneficial Owner Definition

The IPA considers that the definition adopted by the Financial Action Task Force (FATF)^{viii} to be most appropriate, *i.e.*, “*natural persons(s) who ultimately controls and/or the natural person on whose behalf a transaction is being conducted. It also includes those persons who exercise ultimate effective control over a legal person or arrangement*”. The person(s) described in the above definition could also be referred to as a person(s) with significant control (PSC), as is currently the case in the UK.

Tests of Controlling Interest

The five conditions/tests adopted by the UK in defining a PSC, taking into account the concepts in the FATF Guidance^{ix}, are suitable for adoption within the Australian environment.

The tests in the UK state that a PSC is an individual who;

- (i) *Directly or indirectly holds more than 25% of shares in the company*
- (ii) *Directly or indirectly holds more than 25% of voting rights in the company*

- (iii) Directly or indirectly holds the right to appoint or remove a majority of the directors of the company*
- (iv) Has the right to exercise, or actually exercises, significant influence or control over the company*
- (v) Where a trust or firm would satisfy one of the first four conditions if it were an individual, any individual holding the right to exercise, or actually exercising, significant influence or control over the activities of that trust or firm. This is not limited to the trustee of the trust.*

We believe that existing provisions within the Corporations Act and Accounting Standards will need to be relied upon to aggregate ownership of shares and relevant interests by other related parties and associates. It is noted, however, that aspects of the approach taken by the UK in their definition of a PSC are compatible with the accounting standards on related party disclosures and also the definition of control embedded in the accounting standards on consolidations. In this regard, any work undertaken in Australia in defining a PSC, should concomitantly acknowledge the significant work already undertaken in the UK for the purposes defining and also operationalising a workable definition of a PSC.

Information for individuals deemed to be PSCs

The IPA believes that there is a need to ensure that regulators get sufficient information so as to be able to undertake their statutory obligations under the Corporations Act as well as ensuring that only a minimum amount of information is shown in the public domain. The UK model for the PSCs requires the following information for individuals:

- name,
- service address,
- the country or state (or part of the United Kingdom) in which the individual is usually resident,
- nationality,
- date of birth,
- usual residential address,
- the date on which the individual became a registrable person in relation to the company in question,
- the nature of his or her control over that company, and
- whether restrictions on using or disclosing any of the individual's PSC particulars are in force.

In addition, entities that are PSCs are further required to provide the following information in the UK:

- corporate or firm name
- registered or principal office,
- the legal form of the entity and the law by which it is governed,
- if applicable, the register of companies in which it is entered (including details of the state) and its registration number in that register,
- the date on which it became a registrable relevant legal entity in relation to the company in question, and
- the nature of its control over that company.

It is recommended that the details as required in the UK model for PSCs are similarly required and collected in Australia, and be made available for public viewing via an online registry, subject to some restrictions relating to personal information (such as for example, private addresses and telephone numbers). A limited amount of information consisting of the following would meet the necessary requirements for public access:

- Name
- service address,
- the country or state (or part of the Australia) in which the individual is usually resident,
- nationality,
- date of birth,

The five components of information mentioned above should be sufficient for members of the public to get a degree of comfort about the identity of individuals with beneficial interests in a company. Investigators, however, would still be able to access the more detailed information.

We note that nothing has come to our attention that would suggest the disclosures required of entities that are PSCs in the UK would be inappropriate in Australia.

Operations of a central registry for disclosure

The corporate regulator in Australia already has a registry for company details used for recording and storing company information. The existing system should be modified to the extent required in order to accommodate the changes in disclosure requirements for PSCs.

It is critical to ensure that all of the information on this register is readily available to regulators participating in investigations of entities irrespective of the nature of those investigations.

Collection and storage of details of beneficial ownership

Any obligations placed on companies to compile data related to beneficial ownership should be designed so that they align with other compliance duties. Companies should be required to compile and maintain details of individuals that have beneficial ownership of entities in the same manner as they are required to maintain and revise details of basic company details such as the entity's name for example. These details should be compiled when an entity is first incorporated and maintained for the life of the entity. It should also be the responsibility of the entity to ensure that the details are lodged with the corporate regulator and updated as ownership details change.

Any changes to the details of beneficial ownership should be lodged within the same timeframe that a company must lodge changes to company details such as adding or removing directors or amending contact details. Those changes are required to be lodged within 28 days of a decision being made to change a director or company secretary. Changes in beneficial ownership should be lodged within a similar timeframe.

Companies are also obliged to check details kept on the register of the regulator at least once a year, which will usually take place on the anniversary date of the company's initial registration. The review of board membership, entity details and details of individuals that hold a beneficial ownership in these entities should be reviewed and revised as required at the same time. This would streamline the compliance process for an entity rather than have separate disclosure processes that would take more time. Existing Form 484 could be modified for online lodgement to ensure the details of beneficial owners are captured appropriately.

It is noted, however, that a beneficial owner is not a formal office bearer such as a director or a company secretary and as such details such as their dates of birth and addresses should not be disclosed to members of the public. The name and the fact they meet the definition of a PSC must be disclosed in order to meet the underlying disclosure objectives.

Sanctions

The UK disclosure regime has several sanctions in place for a failure to comply with legal requirements. There are criminal offences in the UK^x and Australia should similarly apply such criminal sanctions. While the penalties imposed in the UK include fines and prison sentences

of up to two years, Australia's current enforcement regime only incorporates fines for failure to lodge on time. For example, a failure to lodge changes to company details up to one month after the anniversary date of company registration in Australia is \$76.00, whereas the fee for late lodgement of a document that exceeds a month is \$316.00.

Whether fines of this nature serve as a sufficient incentive for timely lodgement of sensitive information is an issue that merits further exploration by the government. This is one way of ensuring that the registers are complete and authorities are able to access required information to continue their investigations.

Transitional arrangements

Companies will need to be given a period of time to understand new disclosure rules and gather the information for compliance purposes. An initial period of three months with the ability to extend lodgement requirements by a further month on request with the relevant regulatory agency, should be sufficient for entities to gather the appropriate details from those deemed to the PSC.

Impact of measures on entities

Any changes in regulation comes with the need for entities to update their systems for information collection so that collecting the changing details becomes routine over time. Entities will need to work out the best way of ensuring they maintain their own internal register

The IPA welcomes the opportunity to discuss further any of the matters we have put forward in our submission. Please address all further enquires to myself (tony.greco@publicaccountants.org.au or 0419 369 038).

Yours sincerely,

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Endnotes

ⁱ Feldman., J.G., and Teberg., R.L, (1966) Beneficial Ownership under Section 16 of the Securities Exchange Act of 1934. Case Western Reserve Law Review 1054: Vol 17: Issue 4/6.

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ⁱⁱ Blue. M., F (1975) Nominee Shareholding in Australia, The Adelaide Law Review, 5(2) Adelaide Law Review, 188-205.

ⁱⁱⁱ Muniandy, P., Tanewski, G., and Johl, S. (2016). Institutional investors in Australia: do they play a homogenous monitoring role? Pacific-Basin Finance Journal, 40, 266-288.

^{iv} Department for Business Innovation & Skills (2013) Transparency & Trust: Enhancing the transparency of UK company ownership and increasing trust in UK business – Discussion Paper, Department of Business Innovation & Skills, London.

Department for Business Innovation & Skills (2014) Transparency & Trust: Enhancing the transparency of UK company ownership and increasing trust in UK business – Government Response, Department of Business Innovation & Skills, London.

^v The SEC web site can be viewed at www.sec.gov and the electronic lodgement.

^{vi} Australian Securities & Investments Commission (2013) Regulatory Guide 5: Relevant Interests and substantial holding notices November 2013, ASIC, Sydney.

^{vii} Australian Securities & Investments Commission (2008) Regulatory Guide 193: Notification of directors' interests in securities – listed companies June 2008, ASIC, Sydney.

^{viii} Financial Action Task Force (2014) FATF Guidance: Transparency and beneficial ownership October 2014, Paris, France.

^{ix} Ibid, 2014.

^x Federal Treasury (2017) Increasing transparency of the beneficial ownership of companies – Consultation paper February 2017, Australian Government, Canberra.