

KPMG submission

Treasury Consultation Paper

*Increasing Transparency of the
Beneficial Ownership of Companies*

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Executive Summary

We welcome the opportunity to comment on the Treasury consultation paper on *Increasing Transparency of the Beneficial Ownership of Companies* published by Treasury.

We support the policy objective of preventing the misuse of organisational structures for illicit activities.

However, converting this into law that achieves the admirable policy objective in a meaningful way without significant compliance costs and without creating significant expectation gaps will be challenging. Our submission highlights some of the challenges, potential expectation gaps and raises questions over the level of transparency required.

In our view, further analysis is needed before concluding that a beneficial ownership register is the preferred solution and if so, what type. Notwithstanding, our submission also comments on a number of the specific proposals outlined in the consultation paper.

KPMG recommendations are as follows:

Recommendation 1:

Achievement of the policy objective, namely assisting in preventing the misuse of organisational structures for illicit activities, would benefit from more detailed consideration of the design options through a multi-stakeholder engagement process.

Recommendation 2:

A combination of using existing information already collected by regulators (with possible modifications thereto) and/or imposing obligations at the company and shareholder levels to access natural person, beneficial ownership information appears to be the preferred high level design options.

Recommendation 3:

(a) Australian listed companies should be exempt from the new requirements.

(b) Further multi-stakeholder consideration should be given to extending the exemption to a wider group of Australian and foreign owned companies.

Recommendation 4:

- (a) Defining beneficial ownership should be consistent with internationally agreed principles.
- (b) Where feasible, the detailed rules, should seek to leverage off pre-existing domestic models and other international models.
- (c) Designing the optimal detailed rules is likely to require trade-offs and option analysis.

Recommendation 5:

- (a) Beneficial ownership information should be collected at the company level and consistent with Recommendation 2, obligations to report information should be imposed at both the company and shareholder levels.
- (b) It would be preferable if the information collected was reported to a central regulator.
- (c) It would also be preferable if a centralised beneficial ownership register was established, however consistent with Recommendation 1 and 4, this requires further cost/benefit analysis as against less ambitious options.

Recommendation 6:

- (a) Beneficial ownership information should be capable of being shared between relevant domestic and international authorities.
- (b) Regulated financial institutions and other service providers required to undertake customer due diligence could also benefit from access this information, albeit there are a number of inter-dependencies.
- (c) Longer term, we consider that confidential access rights and protocols to a centralised register of information has a better chance of delivering the optimal outcomes.

Detailed comments

1. General

1.1 KPMG welcomes the opportunity to comment on the Treasury Consultation Paper (CP) *Increasing Transparency of the Beneficial Ownership of Companies* released on 13 February 2017.

1.2 Our submission focuses on a number of key issues rather than attempting to provide specific responses to each of the 48 questions.

1.3 At the outset, we wish to make a number of general observations:-

- We support the policy objective of preventing the misuse of organisational structures for illicit activities;
- There is, of course, always an implementation risk with such policies. That is, those engaged in illicit activities will either ignore the new rules or exploit loopholes, which could result in a disproportionate compliance burden to legitimate companies, compared with companies who will attempt to circumvent such policies. Thus converting the admirable policy objectives into well designed law can be challenging;
- The Financial Action Task Force (FATF)¹ acknowledges that one of the three possible methods for ensuring the ready availability of beneficial ownership information is the use of existing information collected (which presumably also covers modifications to, or better use of, current information and associated access and exchange powers). However, whilst the CP presents an outline of Australia's current framework, there is little empirical evidence that a gap analysis has been performed and why the proposed beneficial ownership register is the better solution;
- At this stage, we would caution against the endorsement of a measure that:-
 - is limited to corporate vehicles (i.e. it does not address trusts, partnerships and other legal structures or contractual arrangements) and thus is open to exploitation,

¹ The FATF has set global standards for increasing beneficial ownership transparency

- is mainly focussed on domestic transparency (i.e. it does not address the greater challenges faced by Australian regulators in tracing offshore beneficial ownership) and is thus only a partial solution,
- has not been the subject of a multi-stakeholder engagement process, including a rigorous cost/benefit analysis as against other possible design options.

1.4 In this regard, we note the United Kingdom’s implementation of its Register of People with Significant Control (UK PSC Register), took three years to develop and involved design modifications along the way, various impact assessment studies, extensive consultation processes and various specific issue working groups.

1.5 **Recommendation 1**

Achievement of the policy objective, namely assisting in preventing the misuse of organisational structures for illicit activities, would benefit from more detailed consideration of the design options through a multi-stakeholder engagement process.

1.6 Notwithstanding the above recommendation, we have included below our specific comments on the CP’s proposals for a beneficial ownership register of Australian companies.

2. **Beneficial ownership register of Australian companies**

2.1 **FATF implementation guidance and possible high level approaches.** The FATF suggests 3 methods (including a combination thereof) for ensuring regulatory authorities have relevant ownership information detailing the natural persons who ultimately have a controlling interest in a company:-

- Require companies or company registries to obtain and hold accurate and up to date information on beneficial ownership;
- Require companies to take reasonable measures to obtain and hold up to date information on beneficial ownership; and
- Using existing information, including information obtained by regulatory bodies, tax authorities as well as potentially information obtained by financial institutions and service providers required to undertake customer due diligence.

Conceptually, the first method appears to be the preferred option as it requires companies to know their beneficial owners. It therefore has less inherent risk than the second method, that is, a ‘reasonable measures’ criteria may create loopholes to be exploited by illicit companies. On the other hand, where the beneficial owners are not

participants in the company's management, the company will be beholden to the known shareholders to provide relevant and timely information (particularly in circumstances where the regime uses a broad associate-inclusive definition).

As noted earlier in section 1 of this submission, it is not apparent from the CP whether the third option, namely, the use of existing information sources (or modifications thereto) may already provide the solution.

We do note, however, the Australian Taxation Office (ATO) already asks beneficial ownership questions in the company tax return (albeit currently limited, but clearly capable of being modified); both the income tax laws and tax administration practices have a long history of grappling with the pitfalls of beneficial ownership rules and developing tracing solutions – these might be capable of being leveraged; and, the ATO already has a legislative framework that facilitates wide domestic information gathering powers and an extensive international exchange of information network.

When coupled with the existing Corporations law requirements, Australian Securities and Investments Commission (ASIC) powers, the Australian Business registry as well as possible enhancements to some or all of the above, the anecdotal evidence suggests that at least a partial solution might already exist through existing information sources and channels available to the regulatory authorities. However, we also acknowledge that special consideration would need to be given to the implications of this method under various privacy and secrecy rules.

2.2 Recommendation 2

A combination of using existing information already collected by various regulators (with possible modifications thereto) and/or imposing obligations at the company and shareholder levels to access natural person, beneficial ownership information appears to be the preferred high level design options.

2.3 Which companies could be out of scope?

Certain Australian owned companies

Given the levels of transparency that already applies to Australian listed companies, it is appropriate to grant beneficial ownership register exemptions to such entities. Even if relevant authorities may encounter some difficulties with the existing ownership information collected for listed companies, a risk based approach is likely to conclude that the compliance costs are not justifiable.

We consider this exemption could apply to companies listed on specifically approved exchanges, which may include the ASX and Chi-X (for Australia), the New York Stock Exchange and the NASDAQ (for the US), the London Stock Exchange (for the UK), etc., without creating undue exploitation risks. If residual concerns remain, regulations could provide for exchanges to be ‘black listed’ in exceptional circumstances.

Further, wholly owned subsidiaries of approved listed entities could be offered an exemption without undue concern. Thus, some form of beneficial ownership register exemption ‘class order’ for subsidiaries of entities listed on approved exchanges (including listed trusts), possibly extending to entities where these listed entities exert significant influence and or majority ownership, appears worthy of consideration.

We also suspect there are likely to be other types of non-listed Australian companies/groups that may warrant a similar exemption class order. For example, they might be subject to appropriate regulatory oversight or, their ownership structure strongly infers there will no natural persons who ultimately control the company/group (e.g. companies controlled by large superannuation funds/collective investment vehicles; companies owned by governments; companies with certain ownership restrictions, financial institutions licenced by APRA and ASIC, etc.).

In summary, consideration should be given to exemption class orders for a range of Australian owned companies, not just Australian listed companies.

Certain Foreign owned companies

It is noted the obligations to maintain a register under the UK PSC Register rules do not apply to foreign companies (even those with operations in the UK). Presumably, this approach was based on considerations of territorial nexus and to avoid a doubling up of any FATF obligations introduced in other jurisdictions.

For Australian companies that are ultimately controlled by foreign owned entities listed on approved exchanges (or controlled by foreign governments), a risk based assessment may also conclude that such entities could be worthy of an exemption class order.

In addition, other Australian companies that are foreign owned may be worthy of an exemption class order on the basis that beneficial ownership information is already in

the hands of Australian agencies, or could be obtained if needed. Possible examples include companies that are subject to ATO country by country reporting obligations or are required to ensure general purpose financial reports are filed with the ATO.

Further consideration should therefore be given to a range of foreign owned companies that could be worthy of exemption class orders under a sensible risk based approach.

Exemption trade-offs and inter-dependencies

The potential benefits of the above risk based approach and broad exemption class orders is to reduce the associated compliance costs for companies where the risk of their misuse is lower. However, we acknowledge there are potential downsides with this approach, namely:-

- Less utility in any central register of information for regulators and regulated entities required to undertake customer due diligence, if their statutory obligations have a higher onus of proof in establishing beneficial ownership;
- Sections of the community may perceive that any lessening of existing statutory obligations on regulators and regulated entities to accommodate lower end user compliance costs is a ‘watering down’ of a zero tolerance approach to illicit activities;
- Some statutory obligations of regulators and regulated entities might not be capable of being changed because they are set by international consensus (e.g. Common Reporting Standards);
- There could be transitional and ongoing costs for regulators and regulated entities that may offset any end user compliance savings.

Thus, even if a domestic beneficial ownership register of companies was immediately pursued notwithstanding Recommendation 1, a multi-stakeholder engagement process is still needed for the design of this register.

2.4 Recommendation 3

- (a) Australian listed companies should be exempt from the new requirements.
- (b) Further multi-stakeholder consideration should be given to extending the exemption to a wider group of Australian and foreign owned companies.

2.5 **Defining beneficial ownership.** The FATF plays a key role in facilitating a set of agreed international standards for combating various forms of illicit activity. Moreover, Australia is committed to implementing the FATF's recommendations and Australia stands to benefit from the international exchange of information that is based around broadly comparable standards.

Accordingly, in our view, the FATF guidance should:

- Inform the high level principles which underpin any Australian regime;
- Help define the natural persons who have a controlling interest in a company;
- Help identify the type of information to be collected.

Having said this, it is also apparent the FATF's guidance has been deliberately crafted to allow flexibility, particularly in light on the regulatory regimes already in existence in particular countries.

Where feasible, it would be sensible to leverage off pre-existing domestic models and definitions, such as the definition of Beneficial Owner as contained in the Anti-Money Laundering and Counter Terrorism Financing Rules Instrument 2007 (No1) and the beneficial ownership of shares and member registers under the *Corporations Act (2001)*. AUSTRAC and ASIC regulatory guidance already exists, and could be road tested for suitability in achieving the specific policy objective. Other international models specifically designed to create a beneficial ownership register, such as the UK PSC Register, should also considered rather than trying to reinvent the wheel.

In our view, the beneficial ownership test is likely to have the following features:

- No testing is required if the company or shareholders satisfy certain exemptions or class orders;
- If testing is required, essentially it would be a process of the immediate shareholders reporting to the company, coupled with certain obligations imposed on the company and the shareholders to consider if significant influence/control occurs by other means;
- The testing is likely to include a percentage ownership rule (with a 25% threshold being a likely starting point) together with an associate-inclusive rule;

- An additional rule would seek to capture significant influence or control by other means;
- Even though the register is only dealing with companies, the test will still have to consider how the rules are to be applied when the shareholders are trusts, partnerships, etc;
- Special provisions will be required to deal with specific practical implementation problems, including imposing tracing obligations on foreign shareholders.

It is apparent that the above suggested features of a beneficial ownership test may not accommodate the ‘wish list’ of the regulator nor the regulated entities with customer due diligence obligations.

Where their statutory duties involving tracing beyond immediate shareholders to ‘ultimate’ beneficial ownership, the regulators and regulated entities may prefer for the register to report the ultimate beneficial owners at the company level (i.e., having one record per entity that lists all of their ultimate beneficial owners), rather than requiring the regulator and the regulated entity to do their own tracing exercise through each company in a corporate group.

In this regard, we note the following:-

- In theory, determining the ultimate beneficial owners of closely held companies should be easier than for publicly listed and other widely held companies. Thus, requiring ultimate beneficial ownership information for companies but with various class order concessions for widely-held companies seems conceptually attractive in the design of the register;
- However, once it is accepted that the regime needs a broadly drafted beneficial ownership test (including associate-inclusive rules) to minimise loopholes in the regime, the theory starts to fall away in practice;
- It is our experience that closely held private companies can often have one or more of the following ownership features:
 - multiple classes of shares (which can be registered with ASIC as beneficially or not beneficially held),
 - novel voting, dividend and capital rights,

- unique governance, control and shareholder agreements (e.g. deceased estates controlling ‘from the grave’),
- constitutional clauses impacting on different rights or being triggered on the happening of different events,
- formal and informal arrangements,
- shareholders falling within an associate inclusive definition but actually behaving totally independently (and vice versa);
- It is also our experience in undertaking beneficial ownership testing under the tax laws and the *Corporations Act (2001)* (each of which have their own unique, broadly drafted beneficial ownership tests) that both widely held and closely held companies (plus the ATO and ASIC) can often face significant compliance tracing costs in following the letter of the law.

In summary, we suspect the compliance costs of requiring the collection of ultimate beneficial ownership information at the individual company level will be substantially higher, but if not required, the utility of the register will be diminished. A possible solution to this trade-off dilemma is whether the register might be capable of automating its own ultimate tracing exercise, albeit we suspect this will be easier said than done.

Like the UK PSC Register experience, cost/benefit option analysis needs to be performed together with robust compliance cost surveys.

2.6 **Recommendation 4**

- (a) Defining beneficial ownership should be consistent with internationally agreed principles.
- (b) Where feasible, the detailed rules, should seek to leverage off pre-existing domestic models and other international models.
- (c) Designing the optimal detailed rules is likely to require trade-offs and option analysis.

2.7 **How should beneficial ownership information be collected and stored?** We consider that beneficial ownership information should be collected by the relevant company because:-

- It is consistent with existing member register processes;

- Broad rules governing the beneficial ownership test may well require different control tests to be considered at both the shareholder and company level;
- Separate reporting by shareholders and the company direct to a regulator seems cumbersome and more prone to errors;
- This could be supplemented with the regulator being able to make its own tracing inquiries to the company or direct to shareholders; and
- Where they seek to access a designated service (such as a bank account) in Australia, they are required to provide information regarding their ultimate beneficial owners to the Reporting Entity (i.e. the Bank that provides their bank account) during their account opening process.

We also consider that a model whereby the beneficial information collected by the company is reported to a central regulator is preferable because:-

- It will act as the ‘one source of truth’ for information, rather than having many other conflicting information sources;
- It should be easier to apply consistency rules with regards the recording of and updating of beneficial ownership information;
- A lack of any reporting obligation on a company or shareholder until a request is made by a regulator significantly diminishes any proposed transparency benefits;
- There is less chance of beneficial ownership information collection systems falling into disrepair or information collected being out of date if there was a reporting obligation;
- There are already *Corporations Act (2001)* processes in place for reporting member information by the company to a central regulator and ASIC already has a type of central register with, inter alia, company member information.
- A central register of beneficial ownership information has its attractions as it should improve access to the information and enhance compliance monitoring for the regulators and regulated entities involved in anti-money laundering and tax transparency laws. The regulator’s role should include ensuring the information on the register is accurate, up to date and reliable (under a sensible risk based lens), otherwise there appears to be little point in establishing the register.

However, it needs to be recognised there will inevitably be expectations gaps in what regulators and regulated entities would like and what is achievable. Section 2.5 above already highlights practical concerns as to what the register is capable of reporting. There are likely to other expectation gaps if the register must be updated more regularly than on an annual cycle in order to satisfy statutory obligations.

2.8 Recommendation 5

- (a) Beneficial ownership information should be collected at the company level and consistent with Recommendation 2, obligations to report information should be imposed at both the company and shareholder levels.
- (b) It would be preferable if the information collected was reported to a central regulator.
- (c) It would also be preferable if a centralised beneficial ownership register was established, however consistent with Recommendation 1 and 4, this requires further cost/benefit analysis as against less ambitious options.

2.9 **Access to the information.** We consider that beneficial ownership information should be capable of being shared between relevant domestic and international authorities, subject to appropriate safeguards and protocols.

In addition, if regulated financial institutions and other service providers required to undertake customer due diligence could access this information, this could significantly reduce their compliance costs. Indeed, if these regulated entities did not get access to this information then we would question why the register is being considered at all. Of course, getting access to the register does not guarantee compliance savings are achieved if the final design of the register (e.g. what is reported and when it is updated) cannot satisfy their statutory obligations. Thus there are a number of inter-dependencies in maximising the compliance savings in accessing the beneficial ownership information.

However, overarching all these access matters is the issue of privacy. This issue will only intensify if attempts are made to establish a beneficial ownership register that includes trusts and other legal arrangements.

Whilst we acknowledge some information to be collected from companies and shareholders will already be in the public domain or non-sensitive, we would favour

confidential access rights (and in some cases consent may be prudent in the case of regulated entities) rather than open public access.

We consider that confidential access can overcome the privacy concerns and provides more flexibility longer term in developing a centralised register of information from multiple data sources that is more capable of satisfying multiple regulatory obligations. All this can be achieved without sacrificing the transparency benefits of formal reporting to regulators.

3.0 **Recommendation 6**

- (a) Beneficial ownership information should be capable of being shared between relevant domestic and international authorities.
- (b) Regulated financial institutions and other service providers required to undertake customer due diligence could also benefit from access this information, albeit there are a number of inter-dependencies.
- (c) Longer term, we consider confidential access rights and protocols to a centralised register of information has a better chance of delivering the optimal outcomes.