Consultation paper: Increasing transparency of the beneficial ownership of companies in Australia

10 March 2017

To: The Australian Government, The Treasury

This submission is made on behalf of the Natural Resource Governance Institute (NRGI), a non-profit policy institute based in New York that promotes the responsible management of oil, gas and mineral resources for the public good. Working in over twenty resource-rich countries, NRGI pursues this goal through research, advocacy, capacity development programs, and technical advice to governments and civil society actors. For more information, please see: www.resourcegovernance.org

The paper provides some background to the submission (section 1) and responses to the focus questions asked by the Treasury (section 2).

1. BACKGROUND TO RESPONSE

NRGI's comments are offered from the perspective of an independent non-governmental organization that is seeking evidence of good practices in the detection and prevention of corruption in the extractive industries. As an organization, NRGI believes that corruption in oil, gas and mining can be detected and prevented if oversight actors have the right information at their disposal, including on the beneficial ownership of companies. For the last 18 months, NRGI has built a record in this area and is providing technical assistance on beneficial ownership disclosure implementation in eight countries. As part of the Extractive Industries Transparency Initiative (EITI), countries now have to disclose beneficial owners of companies involved in the oil, gas and mining companies. NRGI has been supporting countries with their EITI beneficial ownership roadmaps, advising on codifying beneficial ownership disclosure in laws and regulations, and producing guidance and analytical materials on the topic.

Furthermore, as part of our research into corruption in the extractive industries over roughly the past two years, we have examined over 100 real-world cases of license or contract awards in the oil, gas and mining sectors where accusations of corruption arose. The cases came from 49 resource-producing countries.

Among the cases we examined, 55—or around half—showed signs that one or more companies had been used to channel benefits to a hidden beneficial owner. Most of these hidden owners, in turn, were Politically Exposed Persons (PEPs). Companies with PEPs as hidden beneficial owners are not uncommon in the extractive industries. Often the participation of a PEP is hidden by a company's ownership structure.

Many of the corporate vehicles that can hide beneficial ownership are not illegal per se, but all should command close review. Some can serve legitimate legal, accounting or operational goals—or purposes such as tax avoidance that, while questionable, do not mean anything illegal or strictly corrupt has occurred. But companies with the kinds of secretive attributes that might help hide the participation of a PEP should receive heightened scrutiny nonetheless, especially whenever including them in the award does not obviously promote any legitimate business or public policy interests.

From our sample of 55 cases, we developed the following list of "warning signs" that a company involved in the extractive industries has a hidden beneficial owner:

- *The company's shareholder structure includes a chain or network of shell companies, or a complex holding company structure, that obscures who ultimately owns or controls the company.*
- *The company has one or more nominee shareholders. Corporate records may explicitly identify the individual as a nominee, or he/she may exhibit common characteristics of nominees—for instance, being a shareholder or director in many other entities; working for a law firm, corporate services firm or other business that specializes in creating shell companies or managing private wealth.*
- *Some of the company's shares are bearer shares.*
- *The company's shareholder structure includes a name that appears to be altered or fabricated. This could be the name of a person or company for which no public records exist; a name that appears to have been deliberately misspelled; a name that no one with relevant knowledge recognizes; a name that otherwise closely resembles some other, identifiable name; or a known or suspected alias, particularly of a PEP.*
- *The company's shareholder structure includes a significant block of authorized but unissued shares. In some—though certainly not all—cases, this could raise suspicions that the company is holding the block of shares in reserve for a PEP.*
- *A list of shareholders for the company—whether contained in a corporate filing or some other official document—does not fully account for all of the company's issued shares.*
- *An individual with familial, personal, political, business or other close financial ties to a PEP is a shareholder, director or officer in the company. Particularly when other red flags are present, this could raise concerns that the individual is a proxy or "front" for the PEP.*
- *A shareholder with a significant interest in the company has a modest, working-class occupation that is unrelated to extractives, and that would not generate sufficient income to buy his/her stake or otherwise contribute financially to the company.*
- *When contacted, a shareholder is unaware that he or she is an owner of the company, suggesting that his or her identity may have been used without his or her knowledge or permission.*

- *An entity in the company's shareholder structure is incorporated in a jurisdiction that does not publicly report on shareholders, or does not collect or records shareholder information.*[1]
- *The company's shareholder structure contains a trust with unknown or unclear beneficiaries.*
- *The company shares a registered or actual physical address, registered agent, office space, phone number, or other business infrastructure with another firm that is owned or controlled by a PEP, or with an individual linked to a PEP.*

This list, along with summaries of some of the real-world cases we analyzed, will be part of a forthcoming NRGI publication on "red flags" of corruption due out in the next month or so.

Our responses to certain of the questions from the consultation paper, included below, are based on NRGI's record of research, analysis and technical assistance just described, and will refer to them throughout.

2. RESPONSES TO SPECIFIC QUESTIONS

3. How should a beneficial owner who has a controlling ownership interest in a company be defined?

Based on our analysis of read-world extractives corruption cases, we are recommending the following definition:

> *"A beneficial owner is a natural person who, directly or indirectly, exercises substantial control over a company or has a substantial economic interest in, or receives substantial economic benefit from, such company."*

This definition, we believe, is best placed to reach cases where a PEP or other individual involved in corruption, not through a formal equity interest but rather by virtue of indirect relationships or other lines of influence, receives a significant part of the company's economic benefit.

The findings of our research further council that language, whether in the definition of "beneficial owner" or elsewhere, about requiring companies to disclose only their "ultimate" BOs should be used carefully—or perhaps preferably, not at all. A company's "ultimate" owner, however defined, is not always clear, either to outsiders or to personnel. Instead, companies should have to disclose all owners that meet the chosen criteria for disclosure. On this point, our cases included a range of instance in which a company provided "substantial economic benefit" to multiple PEPs. For example, we saw cases in which:

- A company acted as a clearinghouse or conduit for payments to many PEPs.

[1] For an assessment of the relative transparency of different jurisdictions with regard to corporate beneficial ownership, see: Global Witness. *Company Ownership: which places are the most and least transparent?* November 2013, p. 1-12: https://www.globalwitness.org/sites/default/files/library/GW_CA_Company%20Ownership%20Paper_download.pdf.

- A PEP acted as a proxy or nominee for a higher-level PEP.
- The company's ownership structure included one or more professional nominee shareholders who represented many officials or other persons in the same or different companies.

These sorts of cases also have led us to conclude that companies participating in beneficial ownership disclosure programs should be required to identify all nominees (both natural and legal persons) and state whom they represent as part of their submissions. This should be the case even if governing law does not require disclosure of nominees in corporate filings or other official documents.

Some of our other responses, below, will take this recommended definition as a starting point.

4. In light of these examples given by the FATF, the tests adopted by the UK (see Part 3.2 above) and the tests applied under the AML/CTF framework and the Corporations Act, what tests or threshold do you think Australia should adopt to determine which beneficial owners have controlling ownership interest in a company such that information needs to be collected to meet the Government's objective?

- ***a. Should there be a test based on ownership of, or otherwise having (together with any associates) a 'relevant interest' in a certain percentage of shares? What percentage would be appropriate?***
- ***b. Alternative to the percentage ownership test, or in addition to, should there be tests based on control that is exerted via means other than owning or having interests in shares, or by a position held in the company? If so, how would those types of control be defined?***

Our research into extractives sector corruption suggests that tying thresholds for ownership and control to particular shareholding percentages (or other quantifiable measures such as percentage of voting rights exercised, number of board seats held) in the disclosing company risks exempting a wide range of cases from the disclosure rules. In particular, guidance on what constitutes "control" ideally would be detailed and take into account less formal scenarios. In a number of the corruption cases we analyzed, a PEP exercised control over a company via informal means, not through commonly understood rules, vehicles and processes of corporate governance. For example, we saw cases in which:

- No clear, single natural person acted as a nominee, proxy or other "front" for the PEP in the disclosing company's ownership structure.
- The PEP did not exercise any voting rights, powers of attorney, or other standard forms of corporate control in the disclosing company.
- The PEP exercised control over the disclosing company in more informal, extralegal ways—e.g., political seniority, blackmail, extortion, other threats, past favors.

If Australia adopted "substantial economic benefit" language for its definition of beneficial owner similar to the language in the definition we recommend above (under Question 3), the guidance accompanying

the disclosure rules should make clear that the rules still apply to beneficial owners who will only receive economic benefit from the company in future. During our research of extractives sector corruption cases, we saw instances in which a PEP arguably had not yet personally received any "substantial economic interest in" or "substantial economic benefit from" a disclosing company but would do so in future. For example, we saw instances in which:

- The disclosing company earned revenues to pay dividends to a PEP, or used its funds to buy assets on behalf of a PEP, but then held these for the PEP, did not distribute to him/her (e.g., held assets in a blind trust).
- The disclosing company held a block of authorized but unissued shares for a PEP.
- The disclosing company provided a PEP with something that only has value in the future (e.g., an unredeemed note, unexercised stock options).
- The disclosing company gave a PEP something that is illiquid, hard to value, for which no market exists, or which has no clear, immediate monetary value.
- The disclosing company paid someone else on orders from a PEP, such that the PEP receives no personal financial benefit.
- The disclosing company made only very small payments on behalf of a PEP (e.g., for travel, housing or entertainment expenses).

Thus far, our research has not reached any "one-size-fits-all" rule or standard for defining when economic benefit should be deemed "substantial" for purposes of detecting and preventing corrupt practices. We have considered a number of different threshold markers, including the value of the benefit conferred to government (e.g., as a percentage of revenues/earnings/profits), the value to recipient (as a percentage of income, salary, assets, etc.), value in local economic terms, number and/or frequency of payments made. Unfortunately, natural resource-related corruption is highly context specific, and it is unlikely that guidance on this point can be drafted in a way to avoid being over- or under-inclusive in some contexts. We will continue to consider the issue as our research goes on.

6. Should the process for identification of beneficial owners operate in such a way that reporting must occur on all entities through to and including the ultimate beneficial owner?

A beneficial ownership disclosure program that will be a useful tool in the detection and prevention of natural resource-related corruption must reach beyond the more obvious, simple cases in which a PEP holds a hidden stake directly in a company via a nominee shareholder, bearer shares or other legal proxy. The corruption case studies from our library included many examples of PEPs holding beneficial interests in more indirect ways and via other legal entities—e.g., through:

- trusts

- complex chains of subsidiary or parent-child/sister company relationships
- different types of holding company structures
- other types of foreign or offshore investment vehicles

As such, disclosure rules ideally would make clear that companies must also report their beneficial owners who hold interests in more indirect ways, and potentially include a (non-exhaustive) list or description of the types of indirect ownership relationships that are covered. Moreover, it may also be advisable to have disclosing companies submit written statements that concretely describing how the beneficial owner holds his/her interest, and/or perhaps a diagram or corporate organogram that shows the relationship visually. Without this additional information, users of the data may often find it difficult to ascertain how the individual holds and exercises his/her ownership or control.

9. What details should be collected and reported for each natural person identified as a beneficial owner who has a controlling ownership interest in a company?

Based on our experience researching and investigating cases of oil, gas and mining sector corruption, we believe that parties attempting to use the information to identify potential corrupt practices would need the following info for each beneficial owner:

- Full name(s) including any former names, alternative names or aliases used.
- Identifying details including date(s) of birth, nationality, national identity number.
- A brief description of the means of ownership or control.
- Addresses of record.
- A description of any nominee, bearer share or other proxy relationship(s) with any legal shareholder.
- If the beneficial owner is/was also a PEP during his/her time as a beneficial owner of the company, a description of why the owner qualifies as a PEP, including information on any public office held and relevant dates in office. This information should be provided irrespective of the size of the PEP's interest in the company.

11. In the case of foreign individuals and bodies corporate, what information is necessary to enable these persons to be appropriately identified by users of the information?

Same answer as for the previous question.