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Imposing Company Ownership Transparency Requirements: Opportunities for Effective Governance of Equity Capital Markets or Constraints on Corporate Performance

Dr. Avnita Lakhani*

Abstract

This article focuses on the relationship between transparency, corporate governance of publicly traded companies, and capital markets. The central question of this article is: if the requirements of ownership transparency are imposed on companies, does this create opportunities for effective governance of capital markets or does this impose constraints on corporate performance? Capital markets include equity markets (stocks) and debt markets (bonds). Equity is the price that investors (e.g., lenders, shareholders) will pay for a company's stock. The value of that equity depends on the company's corporate governance system, which effectively is an equity contract outlining the terms of the equity investment. Corporate governance systems allow stakeholders to monitor the company's performance and to adopt and execute measures to deal with poor performance. Transparency is essential to corporate governance since it allows for the monitoring of company's performance through disclosure of finances, profits, losses, and related reporting. Professor Gilson argues that two forms of transparency are required for effective corporate governance: financial disclosure and ownership transparency.¹ There is ample scholarly literature on the topic of financial disclosure regulations and obligations.

This article focuses primarily on company ownership transparency. Ownership transparency refers to disclosure about majority shareholders, in particular, as well as knowledge and disclosure of minority shareholders for the purposes of protecting such shareholders. On the one hand, ownership transparency can improve a company's performance by preventing "a controlling shareholder's divergence of earnings or opportunities to itself."² On the other hand, ownership transparency requirements may unduly burden issuers and shareholders alike as well as create a negative impact on corporate performance. This article addresses these issues and discusses possible solutions.

Keywords: company ownership disclosure, beneficial ownership, transparency, capital markets, corporate governance, EU Transparency Directive, Securities Exchange Act 1934, international and comparative law

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¹ See Ronald J Gilson, *Transparency, Corporate Governance and Capital Markets*, (2000). This paper was presented at the first meeting of the Latin American Corporate Governance Roundtable, São Paulo, Brazil.

² *Id.* at 6.

INTRODUCTION

Creating companies is synonymous with entrepreneurship, innovation, and, to some, the achievement of a life-long dream. In the United States alone, over two million corporations and limited liability corporations (LLCs) are created annually,³ arguably a testament to the U.S. being an attractive market in which to do business. Similarly, millions of companies are created each day on a worldwide level. However, there is a potential dark side. Many create corporations to fulfill genuine business purposes; in the U.S. alone, for example, states allow people and entities to create companies without knowing the true identity of the company's beneficial owners.⁴ The same is true around the world in other jurisdictions to a lesser or greater extent, especially jurisdictions considered to be tax havens.

In 2013, the International Consortium of Investigative Reporters disclosed almost two million documents that highlighted the problem of identifying owners of company vehicles.⁵ This extensive set of leaked documents revealed the corporate ownership of “thousands of companies and trusts set up in the British Virgin Islands and Cook Islands.”⁶ These previously anonymous owners included “Asian politicians to Canadian lawyers – and no fewer than 4,000 Americans.”⁷ Global Witness, a UK-based non-governmental organization, conducted an investigation into hidden company ownership and found troubling consequences of the non-disclosure of company ownership. For example, in the Democratic Republic of Congo (DRC), the government sold the state's mining assets at below market value to companies registered in the British Virgin Islands, a territory with no formal laws on disclosing company ownership.⁸ The owners of these companies were kept secret. However, the Global Witness investigation

³ Dean Kalant, *Who's in Charge Here?: Requiring More Transparency in Corporate America: Advancements in Beneficial Ownership for Privately Held Companies*, 42 J. MARSHALL L. REV. 1049, 1050 (2009) (citing Staff of Permanent Subcomm. on Investigations, Comm. on Homeland Security and Gov't Affairs, *Levin-Coleman-Obama Introduced Bill to Stop Misuse of U.S. Companies* (May 1, 2008)).

⁴ *Id.* at 1051.

⁵ Max Biedermann, *G8 Principles: Identifying the Anonymous*, 11 B.Y.U. INT'L L. & MGMT. REV. 72, 73-74 (2015).

⁶ *Id.* at 315 (citing *Leaky Devils*, THE ECONOMIST (Apr. 13, 2013), available at <http://www.economist.com/news/finance-and-economics/21576146-tax-havens-start-reassess-their-business-models-leaky-devils>).

⁷ *Id.*

⁸ *Company Ownership: Which places Are the Most and Least Transparent?*, GLOBAL WITNESS 2 (2013) available at https://www.globalwitness.org/sites/default/files/library/GW_CA_Company%20Ownership%20Paper_download.pdf [hereinafter *Global Witness Report*].

discovered that these companies in the British Virgin Islands were associated with an Israeli billionaire who was a friend of the DRC's president.⁹ The state mining assets, which effectively belong to the nation and its people, were sold in the open market at above commercial valuation.¹⁰ The transactions thus created profits for the companies and most likely, the president of the DRC, but resulted in a loss of nearly \$1.3 billion to the nation of Congo and its people.¹¹

There are many more cases similar to the above situation. In 2008, a Financial Times analyst reported on a "secret" method, where the carmaker Porsche used "equity derivatives to conceal economic ownership of shares ('hidden ownership')"¹² to build up a large stake in Volkswagen. A similar phenomenon, "the exercise of voting power without corresponding economic interest ('empty voting'),"¹³ stems from the lack of strong and consistent company ownership disclosure rules. Moreover, in 2010, the United States Senate Permanent Subcommittee on Investigations (the Subcommittee) submitted a report on keeping foreign corruption outside the United States.¹⁴ In its report, the Subcommittee highlighted the histories of four cases regarding foreign corruption, including one case where the son of the president of Equatorial Guinea set up shell companies in the State of California as well as in the British Virgin Islands (BVI) to purchase a \$30 million dollar mansion and a \$37.5 million dollar Gulfstream jet, despite having a mere modest income.¹⁵ The US Senate Subcommittee's 2010 report was consistent with the 2011 World Bank study of 213 large-scale corruption cases, which found that over 70% corruption cases involved the use of shell companies.¹⁶ This scenario in particular highlights the issue of potential

⁹ *Id.*

¹⁰ *Id.* at 2-3.

¹¹ *Id.*

¹² Michael C. Schouten, *The Case for Mandatory Ownership Disclosure*, 15 STAN. J.L. BUS. & FIN. 127, 130 (2009).

¹³ *Id.*

¹⁴ See *Keeping Foreign Corruption out of the United States: Four Case Histories: Hearing Before the Permanent Subcomm. on Investigations, Homeland Sec. & Gov't Affairs, United States Senate* (2010) available at <http://www.gpo.gov/fdsys/pkg/CHRG-111shrg56840/html/CHRG-111shrg56840.htm>.

¹⁵ *Id.*, at 2.

¹⁶ *Poverty, Corruption, and Anonymous Companies*, GLOBAL WITNESS 2 (2014), available at <http://www.globalwitness.org/library/anonymous-companies-global-witness-briefing> [hereinafter *Anonymous Companies*]; see *The Misuse of Corporate Vehicles, Including Trust and Company Service Providers*, FINANCIAL ACTION TASK FORCE (2006), <http://www.fatf-gafi.org/media/fatf/documents/reports/Misuse%20of%20Corporate%20Vehicles%20i>

financial crimes associated with hidden company ownership. Additionally, in September 2013, the BBC News reported on the issue of tax evasion and hidden company ownership by highlighting how the then-209th richest man in America, who had an estimated net worth of \$2.9 billion, “hid more than \$3 million (£ 1.9 million) of income in a secret Swiss bank account.”¹⁷

Each of the above events highlights the dangers of the absence of any mandatory requirement of corporate ownership disclosure, as well as the lack of enforcing the existing rules of beneficial ownership disclosure. It is a potential minefield laced with a deadly combination of low corporate and financial innovation, questionable profit, and unsustainable company practices that can lead to self-dealing (e.g., asset stripping, related party transactions, and share dilutions), tax evasion, money laundering, terrorism financing, and other financial crimes resulting from and encouraging the non-disclosure of a company’s ownership.¹⁸

The increasing risks of hidden company ownership finally reached the attention of high-level political leaders at the 2013 G8 Summit in Lough Erne, Northern Ireland. The G8 countries (Canada, France, Germany, Italy, Japan, Russia, United States of America, and the United Kingdom) announced the “G8 Principles,” a set of eight principles, or a “beneficial ownership action plan,”¹⁹ designed to improve the transparency of company ownership as well as combat the misuse and abuse of companies via legal arrangements.

This article focuses on the relationship between transparency (in particular, transparency of company ownership), corporate governance of

ncluding%20Trusts%20and%20Company%20Services%20Providers.pdf (stating that a shell company has no viable operations or assets); *see also The Role of Domestic Shell Companies in Financial Crime and Money Laundering: Limited Liability Companies*, DEPARTMENT OF THE TREASURY FINANCIAL CRIMES ENFORCEMENT NETWORK 2-4 (2006), http://www.fincen.gov/news_room/rp/files/LLCAssessment_FINAL.pdf.

¹⁷ *Beanie Babies creator Ty Warner to admit tax evasion*, BBC NEWS (September 18, 2013), <http://www.bbc.co.uk/news/business-24155274>.

¹⁸ Biedermann, *supra* note 5, at 72; *see also* John G. Edwards, *Registered Agents Fight Bill Requiring Corporate Ownership Records*, L. V. REV. J. (May 3, 2008), available at 2008 WLNR 8389953 (hereinafter *Registered Agents*) (explaining that while not all corporations and LLCs are created for illegitimate reasons, lack of beneficial owner transparency has caused numerous problems relating to money laundering, tax evasion, terrorism, and other misconduct).

¹⁹ Biedermann, *supra* note 5, at 74; *see also Global Witness Report, supra* note 8, at 2; *G8 Action Plan Principles to Prevent the Misuse of Companies and Legal Arrangements*, GOV.UK (2013), https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/207532/G8-Action-Plan-principles-to-prevent-the-misuse-of-companies-and-legal-arrangements.pdf [hereinafter *G8 Action Plan Principles*].

publicly traded companies and capital markets. The central question of this article can be stated as follows: if requirements of ownership transparency are imposed on companies, does this create opportunities for effective governance of equity capital markets or does this impose constraints on corporate performance?

Following the introduction in Part I of the article, Part II analyses the relationship between capital markets and company ownership disclosure. Part III evaluates the European Union Directive on Transparency (EU Transparency Directive), which is considered one of the most comprehensive directives aimed at increasing disclosure of company beneficial ownership across the European Union. Part IV of the article focuses on initiatives in the United States that aim at improving beneficial ownership transparency, including the current requirements under the U.S. Securities and Exchange Act 1934 and the most recent reintroduction of a proposed bill on corporate transparency called the Incorporation Transparency and Law Enforcement Assistance Act (“ITLEAA” or “the Levin Bill”) in August 2013.²⁰ Part V shifts the focus from the EU and U.S. towards other international efforts in mandating disclosure of beneficial ownership, such as efforts by the Organization of Economic Cooperation and Development (OECD), recommendations by the Financial Action Task Force (FATF), and ownership disclosure regimes of nations other than the EU and U.S. Part VI consolidates the analysis in the previous sections of the article to highlight some of the outstanding issues related to beneficial ownership transparency requirements and its impact on corporate performance, if any. To that end, Part VI of the article makes policy recommendations for addressing these outstanding issues. Finally, Part VII provides concluding remarks.

I. RELATIONSHIP BETWEEN CAPITAL MARKETS AND COMPANY OWNERSHIP DISCLOSURE

A. Building Strong Capital Markets

In his 2001 article on strong securities markets, Professor Bernard Black argued that establishing “the preconditions for a strong market for common stocks and other securities” was a challenge for all economies.²¹ One need only refer to those recent 2015 events in China’s stock exchanges

²⁰ *Incorporation Transparency and Law Enforcement Assistance Act*, S. 1465, 113th Cong. (2013) available at <https://www.congress.gov/bill/113th-congress/senate-bill/1465>.

²¹ Bernard S. Black, *The Legal and Institutional Preconditions for Strong Securities Markets*, 48 UCLA L. REV. 781, 781 (April 2001).

to learn that such challenge is a genuine issue, even today. Professor Black argues that in order to establish a strong market of securities, the complex web of legal and market institutions must address two issues of investor protection, namely ensuring that minority shareholders “(1) receive good information about the value of a company's business and (2) have confidence that a company's managers and controlling shareholders won't cheat them out of most or all of the value of their investment.”²² By pointing out the above issues, Professor Black is more concerned about the transparency of company information, as well as potential issues arising out of the unsavoury conducts of the company directors and controlling shareholders that may impact the company's value and their ripple effects on capital markets. These two requirements are also at the heart of the debate on beneficial ownership disclosure and transparency.²³

For the purposes of this article, capital markets are “meeting places where those who require additional capital seek out others who wish to invest their excess.”²⁴ They can be in the form of long-term debt or equity-backed securities. Capital markets include equity markets (stocks) and debt markets (bonds). As used in this abstract, equity markets refer to stock markets or exchanges (securities), where shares of a company are publicly traded, subject to a variety of regulations, codes of conduct, and charters.

Capital markets can be categorized into primary and secondary markets. Primary markets serve as “a market for creating and originating new financial instruments.”²⁵ Secondary markets are used for trading existing financial instruments and products.²⁶ Equity is the price that investors (e.g., lenders, shareholders) will pay for a company's stock. The value of such equity depends on the company's corporate governance system, which effectively is an equity contract outlining the terms of the equity investment.

²² *Id.*

²³ There is a distinction between disclosure and transparency for while regulations may require issuers and shareholders to disclose their economic interest in a company to intermediaries or agencies, that information may not be transparent to the issuing company or transparent to the public. The level of transparency is key to the debate.

²⁴ ANDREW CHISOLM, AN INTRODUCTION TO CAPITAL MARKETS: PRODUCTS, STRATEGIES, PARTICIPANTS, 1 (John Wiley & Sons, Ltd (2002) (While these meeting places can be physical meeting places, they are now increasing virtual or online meeting places.) Note: Capital markets are distinct from money markets, which are aimed at more short-term loans and financing. *See also* Avnita Lakhani, *China's Shadow Banking Industry and Impact on Capital Markets: Ignoring the Lessons of the Past* (publication forthcoming in the JOURNAL OF INTERNATIONAL COMMERCIAL LAW (August 2015)).

²⁵ CHISOLM, *supra* note 26, at 2.

²⁶ *Id.*

When a company has good corporate governance, the value of its stock is likely to be higher and the cost of borrowing capital lower.²⁷

On a broader scale, good corporate governance ensures that markets and enterprises may function efficiently and in accordance with society's goals.²⁸ A healthy corporate governance system allows stakeholders to monitor the company's performance, and to adopt and execute measures to deal with poor performance. In addition, a sustainable corporate governance framework can promote investor confidence,²⁹ assist the company in meeting investor expectations, allow the exercising of shareholder rights in an effective way,³⁰ encourage sound decision making on behalf of the company, and help regulators and agencies deal with systemic issues such as the ability to "determine the origins of investment flows, to prevent money laundering and tax evasion and to settle issues of corporate accountability."³¹

Transparency is essential to achieve good corporate governance because it provides the ability to monitor company performance through disclosure of finances, profits, losses, and other related reporting. Without transparency, it would be impossible for a country to support equity markets and ensure the stability of industry. As argued by Vermeulen, "a good corporate governance infrastructure should combine transparency, accountability and integrity and this requires knowledge of beneficial

²⁷ See, e.g., Allen Ferrell, *The Case for Mandatory Disclosure in Securities Regulation around the World*, 2 BROOK. J. CORP., FIN. & COM. L. 81, 93 (2007) (discussing the relationship between market efficiency, good corporate governance, and lower cost of capital).

²⁸ Erik P.M. Vermeulen, *Beneficial Ownership and Control: A Comparative Study Disclosure, Information and Enforcement* 5 (March 2012), available at <http://dx.doi.org/10.1787/5k4dkhwckbzv-en>. This paper was discussed in a panel as part of a technical seminar of the OECD Russia Corporate Governance Roundtable organized for March 2012 in Moscow, Russian Federation.

²⁹ See, e.g., Schouten, *supra* note 12, at 132 (quoting the first recital of *Directive 2004/109/EC, On the Harmonisation of Transparency Requirements in Relation to Information About Issuers Whose Securities are Admitted to Trading on a Regulated Market*, O.J. (L 390) 38 (2004) [hereinafter Transparency Directive] to show how one of the purposes of the EU Transparency directive is to boost investor confidence); see also Merritt B. Fox, *Civil Liability and Mandatory Disclosure*, 109 COLUM. L. REV. 237, 253 (2009).

³⁰ Schouten, *supra* note 12, at 134 (citing the Transparency Directive in terms of its goal of "enabl[ing] investors 'to acquire or dispose of shares in full knowledge of changes in the voting structure; it should also enhance effective control of share issuers and overall market transparency of important capital movements'"); Transparency Directive, *supra* note 31, at 18.

³¹ Vermeulen, *supra* note 30, at 5.

ownership.”³² In turn, ownership disclosure improves market efficiency and corporate governance.³³

This knowledge consists of not only the identity of the controlling owners (or, as argued by some, all owners), but also knowledge of the controlling structures of listed companies. Knowledge of beneficial owners and the control structures of listed companies must then be accompanied by effective investigation and enforcement mechanisms regarding disclosed information about beneficial ownership.³⁴

Ownership transparency refers to disclosure regarding majority shareholders³⁵ in particular, but can also refer to disclosure regarding minority shareholders for the purposes of protecting such shareholders. As seen by recent events, majority shareholders can play an activist or pacifist role as owners of a company, thus affecting the company’s performance. As highlighted by Professor Gilson, a company’s performance can suffer “a controlling shareholder’s divergence of earnings or opportunities to itself.”³⁶

Transparency and disclosure of ownership provides numerous benefits to the capital market and society as a whole. First, it can facilitate better management of the company and produce a positive impact on capital markets.³⁷ For example, ownership disclosure can improve market efficiency by “creating transparency of the voting structure and of changes in the voting structure...enable[ing] investors to anticipate agency costs and to assess the implications for the value of a firm's share,”³⁸ and inform share price as well as ensure the accuracy of that price “by creating transparency of economic

³² Vermeulen, *supra* note 30, at 2; Gilson, *supra* note 1 at 6, 7 (stating that two forms of transparency, financial disclosure and ownership transparency, are required for effective corporate governance); *OECD Principles of Corporate Governance* ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) 51 (2004) (stating that ownership disclosure is “one of the basic rights' of investors”).

³³ See Schouten, *supra* note 12, at 133 (defining an efficient market as one “in which prices always fully reflect available information.”); Gilson, *supra* note 1, at 6; see also Eugene F. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FIN. 383 (1970).

³⁴ Vermeulen, *supra* note 30, at 15.

³⁵ Gilson, *supra* note 1, at 6 (defining ownership transparency such that “companies disclose the identity of shareholders who own significant amounts of corporate stock, as required in the United States by the Securities Exchange Act and in the European Community by the Transparency Directive.”)

³⁶ *Id.*

³⁷ As an example, once can look at recent events in July 2015 where China’s stock market plunged and suffered a rout. There, the majority of controlling shareholders are state-owned companies although in Shanghai’s stock exchange, the players are mainly private investors in company stock.

³⁸ Schouten, *supra* note 12, at 180.

interests of shareholders, of trading interest and of the size of the free float.³⁹ Second, ownership disclosure can improve enforcement within firms of both concentrated ownership and dispersed ownership. In firms with concentrated ownership, or “blockholder systems,” such as those found in Europe, Asia, and most other capitalist economies,⁴⁰ disclosure of beneficial ownership allows for better “monitoring of the controlling shareholder, thus preventing extraction of private benefits.”⁴¹ In firms with dispersed ownership or so-called market systems characterized by “small and numerous shareholdings, liquid trading markets...high frequency trading and rapid and continuous changes in share ownership,”⁴² disclosure of beneficial ownership improves enforcement “by facilitating the market for corporate control, the mechanism through which management is disciplined by takeovers and the threat thereof”⁴³ and by “facilitat[ing] communication among shareholders and between companies and their shareholders.”⁴⁴

However, a counter-argument often made is that ownership transparency requirements may unduly burden the controlling shareholders and negatively impact corporate performance since such ownership transparency requirements may disclose shareholders’ financial standing, prevent activism necessary to promote corporate growth, and result in a level of corporate politics that is detrimental to effective corporate governance. In the hands of the unscrupulous, too much information can become a sword that cuts the shield of good intentions and good corporate governance. Currently the debate and laws surrounding the requirements of disclosure of company ownership have mainly focused on ‘beneficial ownership’ transparency. However, clearly defining ‘beneficial ownership’ is a difficult task, and enforcing sufficient transparency requirements can be more complicated than expected.

³⁹*Id.*; see, e.g., Merritt B. Fox et al., *Law, Share Price Accuracy and Economic Performance: The New Evidence*, 102 MICH. L. REV. 331, 348-368 (2003) (studying the relationship between strict disclosure requirements and finding that “[t]he results of the study suggest that share prices became more informed as a result of the enhanced disclosure requirements, which supports the view that mandatory issuer disclosure can increase share price accuracy and share price informedness.”); see also Schouten, *supra* note 12, at 134.

⁴⁰ Vermeulen, *supra* note 30, at 7 (discussing the ‘vertical agency problem’ in firms with concentrated ownership or blockholder systems).

⁴¹ Schouten, *supra* note 12, at 180.

⁴² Vermeulen, *supra* note 30, at 7, 18 (discussing the ‘vertical agency problem’ in firms with dispersed ownership or market systems).

⁴³ Schouten, *supra* note 12, at 180.

⁴⁴ *Id.*

B. Defining and Disclosing Beneficial Ownership

The United Kingdom created the legal concept of beneficial ownership under its trust laws.⁴⁵ A beneficiary is defined as one who “ultimately controls an asset and can benefit from it.”⁴⁶ The Financial Action Task Force (FATF) defines beneficial ownership as “the natural person(s) who ultimately owns or controls a customer and/or the natural person on whose behalf a transaction is being conducted...also includes those persons who exercise ultimate effective control over a legal person or arrangement.”⁴⁷

In the United States, Rule 13d-3(a) of the Securities and Exchange Act of 1934 defines a beneficial owner of a security as:

Any person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise has or shares: (i) voting power which includes the power to vote, or to direct the voting of, such security; and/or, (ii) investment power which includes the power to dispose, or to direct the disposition of, such security.⁴⁸

However, the newly proposed Incorporation Transparency and Law Enforcement Assistance Act of 2013 (the “Levin Bill” or “ITLEAA”) does not adopt the same definition of beneficial owner as the Securities & Exchange Act of 1934. According to ITLEAA, a beneficial owner is defined as “an individual who has a level of control over, or entitlement to, the funds or assets of a corporation or [LLC] that, as a practical matter, enables the individual, directly or indirectly, to control, manage, or direct the corporation or [LLC].”⁴⁹

In the European Union (EU), the EU Transparency Directive extends disclosure by the beneficial owner, which extends to encompass a variety of definitions. For example, as explained by Schouten, the EU Transparency

⁴⁵ Biedermann, *supra* note 3, at 74.

⁴⁶ *Id.* (quoting Emile Van Der Does De Willebois, Emily H. Halter, Robert A. Harrison, Ji Won Park & J.C. Sharman, *The Puppet Masters*, 18 (2010), available at <http://issuu.com/world.bank.publications/docs/9780821388945>).

⁴⁷ *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation - the FATF Recommendations*, FINANCIAL ACTION TASK FORCE ON MONEY LAUNDERING 110 (2012), http://www.fatfgafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf

⁴⁸ United States Securities and Exchange Act of 1934, 17 C.F.R. § 240.13d-3(a) (2010); see also Vermeulen, *supra* note 30, at 21.

⁴⁹ Kalant, *supra* note 3, at 1051 (quoting ITLEAA, S. 569, 111th Cong. §3(a)(1)(a)(1)(e)(1) (2009)) (August 2013 was the third time that ITLEAA was introduced before Congress. It was first introduced in May 2008 and re-introduced in March 2009.); see also Vermeulen, *supra* note 30, at 21; Schouten, *supra* note 12, at 164; J. W. Verret, *Terrorism Finance, Business Associations, and the “Incorporation Transparency Act”*, 70 LA. L. REV. 857, 859 (Spring 2010).

Directive uses “various criteria...to try to capture the beneficial owner, such as ‘power to exercise dominant influence or control,’ ‘discretion,’ ‘instruction,’” and “‘independently.’”⁵⁰ Disclosure obligations extend to parties who have access to voting rights,⁵¹ including those who hold shares indirectly through controlled entities. Furthermore, disclosure requirements apply to “parties acting in concert or to parties on whose behalf shares are held by a third party.”⁵² Parties who hold equity derivatives are also considered beneficial owners and are subject to the disclosure requirements.⁵³

A final noteworthy definition of beneficial owner is by Computershare, a listed company that identifies itself as “a global market leader in transfer agency and share registration, employee equity plans, proxy solicitation and stakeholder communications.”⁵⁴ In Computershare’s March 2015 international market analysis of 14 countries⁵⁵ with respect to, among many items, the transparency of share ownership, the report defines beneficial owner as simply “an investor who owns an interest in a security.”⁵⁶ According to Computershare’s definition, the beneficial owner may hold legal title to the shares or has contracted with an intermediary and is thus an indirect holder.⁵⁷ In either case, the beneficial owner “may be entitled to not only monetary rights but also voting rights “depending on local laws and agreements.”⁵⁸ The report also distinguishes between a non-objecting beneficial owner (NOBO) and an objecting beneficial owner (OBO), where a NOBO consents to being disclosed to an issuer as a beneficial owner while an OBO refuses to disclose its identity to the issuer by an intermediary.⁵⁹

⁵⁰ Schouten, *supra* note 12, at 163.

⁵¹ *Id.*

⁵² *Id.* at 163-164, n 84.

⁵³ *Id.* at 164.

⁵⁴ Clare Corney, Kirsten Van Rooijen, and Amanda Kaut, *Transparency of Share Ownership, Shareholder Communications and Voting in Global Capital Markets*, COMPUTERSHARE 46 (2015), [http://www.computershare.com/au/business/gcm/regulatory-and-market-initiatives/submissions-and-](http://www.computershare.com/au/business/gcm/regulatory-and-market-initiatives/submissions-and-papers/Documents/TransparencyofShareOwnershipShareholderCommunicationsandVotinginGlobalCapitalMarkets_12032014.pdf)

[papers/Documents/TransparencyofShareOwnershipShareholderCommunicationsandVotinginGlobalCapitalMarkets_12032014.pdf](http://www.computershare.com/au/business/gcm/regulatory-and-market-initiatives/submissions-and-papers/Documents/TransparencyofShareOwnershipShareholderCommunicationsandVotinginGlobalCapitalMarkets_12032014.pdf) (Note that the report was done in collaboration with Georgeson, a company which identifies itself in the report as “the world’s foremost provider of strategic shareholder services to corporations and shareholder groups working to influence corporate strategy”).

⁵⁵ Corney et al. *supra* note 56 (The 14 countries included in the market analysis included: Australia, China, Hong Kong, India, Japan, France, Germany, Italy, United Kingdom, Spain, Sweden, Russia, United States, and Canada).

⁵⁶ *Id.* at 35.

⁵⁷ *Id.*

⁵⁸ *Id.*

⁵⁹ *Id.*

From the myriad definitions above, two key observations are noteworthy. First, if a valid argument for disclosure of beneficial ownership is made in order to “cure the illness” of hidden company ownership, there must be an easy way to understand and clarify the definition of “beneficial ownership,” which shall apply across all jurisdictions. Specifically, the definition must take into account three key elements: voting power, control power, and investment power. Second, from the perspective of effective disclosure and enforcement, the definition needs to encompass a range of voting, control, and/or investment power that makes the beneficial owner subject to disclosure regulation, investigation, and prosecution. Currently, the definitions are either too all-encompassing, or they are difficult to track and enforce.

C. Defining and Enforcing Transparency

Backer defines transparency as applicable in two arenas. Within an organization or community, transparency “enhances its operation and disciplines its members.”⁶⁰ Outside an organization, transparency can be used “to enhance legitimacy (norm) and accountability (technique) among stakeholders who have an interest in but not a direct participation in the operation of the enterprise.”⁶¹ Defining transparency in the context of mandatory beneficial ownership is also a challenge, yet it is in defining the level of desired transparency that the concept of beneficial ownership disclosure can have any effective and enforceable meaning.

For example, Computershare’s 2015 market analysis report distinguishes between “disclosures required to be made by investors when they trigger certain ownership levels, specified by legislation, and issuer rights to proactively demand identification of their investor.”⁶² Because Computershare’s 2015 report focused on the latter, namely, an issuer’s right to demand a list of their investors, its definition of transparency is “visibility of the underlying beneficial owners of shares to an issuer.”⁶³ This appears to suggest that the issuers and investors have the ability to access a private registry. However, according to Global Witness, transparency measures the

⁶⁰ Larry Catá Backer, *Transparency Between Norm, Technique, and Property in International Law and Governance: The Example of Corporate Disclosure Regimes and Environmental Impacts*, 22 MINN. J. INT'L L. 1, 4 (Winter 2013).

⁶¹ *Id.*

⁶² Corney et al., *supra* note 58, at 1.

⁶³ *Id.* at 35-36.

“need to be exactly that: transparent.”⁶⁴ As argued by Global Witness, this presumes the existence of a public registry since a private registry “no matter how well implemented, is simply not that much help.”⁶⁵ Under Global Witness’ definition of a public registry, details of company ownership would be available to and accessible by everyone in the world, including issuers, investors, journalists, and ordinary citizens, without the boundaries of jurisdictional rules and regulations.

The theory of establishing transparency of beneficial ownership through a public registry garners further support from the second principle of the G8 Principles, the UK’s proposed action plan on beneficial ownership as outlined in a discussion paper called *The Transparency & Trust: Enhancing the Transparency of UK Company Ownership and Increasing Trust in UK Business*, the proposed Levin Bill of the US Congress, and the EU’s Transparency Directive, which foresees that such information will be “disseminated...to the public throughout the Community.”⁶⁶ However, for each of the above-mentioned jurisdictions, the definition of public registry is akin to a national, centralized registry. As acknowledged by the UK, for example, it “cannot require overseas companies operating in the UK to disclose beneficial ownership information to a UK registry.”⁶⁷ It is likely that other jurisdictions face similar restrictions in addition to the costs for both issuers and investors in meeting the requirements for a private or public registry.

Despite the support for transparency, it is clear that the level and nature of transparency with respect to beneficial ownership disclosure has not reached a point of consensus. Such consensus, to a greater degree towards an international public registry, is important if the benefits of mandatory company disclosure are to outweigh the costs.

⁶⁴ *Global Witness Report*, *supra* note 8, at 4.

⁶⁵ *Id.*

⁶⁶ Biedermann, *supra* note 3, at 89-91 (discussing the plans outlined by some G8 countries with respect to a public registry); *see also* Fabrice Demarigny and Christophe Clerc, *Transparency Directive Assessment Report: Executive summary and possible improvements*, VI MAZARS (2009), http://ec.europa.eu/finance/securities/docs/transparency/report-application_summary_en.pdf.

⁶⁷ *Transparency & Trust: Enhancing the Transparency of UK Company Ownership and Increasing Trust in UK Business*, DEPARTMENT FOR BUSINESS INNOVATION AND SKILLS 27, § 2.23 (2013), https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/212079/bis-13-959-transparency-and-trust-enhancing-the-transparency-of-uk-company-ownership-and-increasing-trust-in-uk-business.pdf.

II. EU TRANSPARENCY DIRECTIVE AND OWNERSHIP DISCLOSURE

The European Union (EU) was created through the Maastricht Treaty of 1992, also known as the Treaty on European Union (TEU). Twelve original “High Contracting Parties” (Member Nations) signed the TEU on February 7, 1992, and the TEU entered into force on November 1, 1993.⁶⁸ The TEU also facilitated the creation of the Economic and Monetary Union, which led to the creation of the euro currency in January 1999.⁶⁹ However, the European Communities,⁷⁰ consisting of various EU countries, existed as early as the late 1970s, well before the creation of the European Union.

The EU forged the pathway for a mandatory ownership disclosure scheme beginning in 1988 via the “Major Holdings Disclosure Directive.”⁷¹ Council Directive 88/627/EEC imposed an obligation to disclose major shareholdings when they were acquired and when they were disposed of.⁷² However, due to certain limitations in its application, the Major Holdings Disclosure Directive was repealed and replaced in 2004 by Directive 2004/109/EC (the “Transparency Directive”).⁷³ The Transparency Directive was later amended in 2013 by Directive 2013/50/EU to take into account several improvements such as issuer obligations, and to make regulated markets more attractive to small and medium-sized businesses.⁷⁴ Under the

⁶⁸ See Civitas, *EU Factsheet: Treaty of Maastricht*, CIVITAS.ORG.UK (2014), <http://www.civitas.org.uk/eufacts/FSTREAT/TR3.php> [hereinafter *EU Factsheet*]

⁶⁹ *Id.*; *Timeline: the unfolding eurozone crisis*, BBC NEWS.COM (June 13, 2012), <http://www.bbc.com/news/business13856580> (citing January 1, 1999 as the date when the euro currency ‘officially came into existence’).

⁷⁰ *Greek Profile - Timeline*, BBC.COM (August 11, 2015), <http://www.bbc.com/news/world-europe-17373216> (noting the existence of the European Communities, which was subsequently subsumed by the European Union and Greece, an EU country as being one of its members in 1981).

⁷¹ Schouten, *supra* note 12, at 132 (citing Council Directive 88/627/EEC, On the Information to be Published when a Major Holding in a Listed Company is Acquired or Disposed Of, 1988 O.J. (L 348) 62 (1988)); Holger Fleischer and Klaus Ulrich Schmolke, *The reform of the Transparency Directive: Minimum or Full Harmonisation of Ownership Disclosure?*, 12(1) EUROPEAN BUS. ORG. L.REV., 121-145 (2011)

(discussing the ‘Transparency Directive 1988’).

⁷² Schouten, *supra* note 12, at 132; Vermeulen, *supra* note 30, at 17.

⁷³ Schouten, *supra* note 12, at 132 (citing the Transparency Directive); *see also* Fleischer and Schmolke, *supra* note 75, at 125-126 (discussing the ‘Transparency Directive 2004’).

⁷⁴ *See generally* Directive 2013/50/EU of the European Parliament and of the Council of 22 October 2013 amending Directive 2004/109/EC of the European Parliament and of the Council on the Harmonisation of Transparency Requirements in Relation to Information About Issuers Whose Securities are Admitted to Trading on a Regulated Market, Directive 2003/71/EC of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or

Transparency Directive, persons or entities who “hold or have access to voting rights should disclose their major holdings in listed companies”⁷⁵ in the sense that they must provide “timely information about the acquisition or disposal of voting rights of listed companies... based on thresholds starting at 5%, continuing at intervals of 5% until 30% of voting rights.”⁷⁶ In addition, the Transparency Directive requires both periodic and ad hoc reporting. For example, Article 12(2) requires that, when there is a change in a major shareholding, the issuer must file a notification within four days of when the shareholding falls or exceeds the thresholds in Article 9.⁷⁷ Subsequently, the listing company must inform the public within three days of receiving the notice of the change.⁷⁸ The notification requirement also applies to various classes of shares such as warrants, convertible bonds and some derivatives.⁷⁹

According to Schouten, the disclosure regime of the Transparency Directive improves the transparency of voting structure as well as any changes in such voting structure, which may signal a potential shift in corporate control.⁸⁰ The Transparency Directive regime also enhances transparency of important capital movements such as economic interests, trading interests, and the size of the free float.⁸¹ In addition, Schouten argues that the Transparency Directive plays an important role in improving corporate governance by allowing investors to anticipate and reduce agency costs, and by addressing other agency-related problems.⁸²

In 2009, Mazars published a report on the findings of an assessment of the EU Transparency Directive. The study was part of the European Commission’s obligations under Article 33 of the Transparency Directive.⁸³ Mazars’ methodology consisted of online questionnaires (with a 12% global response rate), shareholder interviews, financial reporting compliance

admitted to trading and Commission Directive 2007/14/EC laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC.

⁷⁵ Schouten, *supra* note 12, at 132.

⁷⁶ Vermeulen, *supra* note 30, at 17 (citing Article 9 of the Transparency Directive).

⁷⁷ *Id.*

⁷⁸ *Id.* (citing Article 9 and Article 12(2) of the Transparency Directive).

⁷⁹ *Id.*

⁸⁰ Schouten, *supra* note 12, at 134-148.

⁸¹ *Id.*

⁸² *Id.* at 148-156 (discussing agency costs and problems in relation to lack of transparency of beneficial owners); Vermeulen, *supra* note 30, at 7-8, 12-14, and 26 (discussing horizontal and vertical agency cost issues).

⁸³ Demarigny and Clerc, *supra* note 70, at VI (discussing harmonization of transparency requirements, particularly under EU Directive 2004/109/EC (Transparency Directive)).

reviews and legal implementation reviews.⁸⁴ The study included feedback from fifteen EU Member States and six non-EU Members, including the U.S., Japan, China, India, Hong Kong and Switzerland.⁸⁵ Stakeholder representatives in the study included issuers of shares and debt or other securities, institutional investors, retail investors associations, financial analysts and financial intermediaries.⁸⁶

While a strong majority of respondents (65%) reported that the Transparency Directive was clear and met the objectives of “providing accurate, comprehensive, and timely information to the market,”⁸⁷ only 32% of non-EU stakeholders had sufficient knowledge, interests, or understanding of the obligations under the Transparency Directive.⁸⁸ And only 16% of non-EU nations “believe that the Directive provides sufficient clarity and predictability.”⁸⁹ Considering the non-EU nations in the study are some of the largest and most developed economies in the world, it does not bode well for the EU’s desire to convince the world of the attractiveness of the single market, particularly in terms of transparency.⁹⁰ Respondents who expressed positive views about the Directive creating a favorable impression of the single market consisted of 66% of non-EU institutional investors.⁹¹

Interestingly enough, in contrast to Schouten’s views, the study results related to information and notification of major holdings under the Transparency Directive were “the most problematic according to the perceptions of stakeholders and the legal assessment of the legal operation in Member States.”⁹² While 78% of financial analysts and institutional investors found the disclosure of major holdings useful for investment purposes and 58% found the disclosure and notification obligations to not impose an unreasonable burden,⁹³ a detailed analysis of responses found several areas of concern with respect to disclosure, notification, and enforcement.

First, many EU member states have adopted more stringent ownership disclosure thresholds, leading to a lack of harmonization in

⁸⁴ Demarigny and Clerc, *supra* note 70, at VI.

⁸⁵ *Id.*

⁸⁶ *Id.* It is important to note that the Report does not specify the total number of individual respondents in the sample size and the total respondents across all methods of collecting the data.

⁸⁷ *Id.* at VII.

⁸⁸ *Id.* at XVII.

⁸⁹ *Id.*

⁹⁰ *Id.*

⁹¹ *Id.*

⁹² *Id.* at XI.

⁹³ *Id.*

implementing the Transparency Directive.⁹⁴ This lack of harmonization means that the notification process is neither simpler nor less burdensome under the Transparency Directive.⁹⁵ Second, respondents reported that the unclear provisions of the Transparency Directive, combined with financial innovation such as “empty voting,” lending of voting rights, cash-settled equity swaps and cash-settled contracts,⁹⁶ “allows certain market players to circumvent transparency requirements,”⁹⁷ thus making the Directive “too rule-based and not sufficiently principle-based.”⁹⁸

Compared with Mazars’ study, Vermeulen’s 2012 comparative analysis of five jurisdictions with respect to their disclosure of control structures and beneficial owners provides insight into whether each jurisdiction had sufficient transparency of beneficial ownership by international standards. In his study, Vermeulen includes Italy as the EU representative country implementing Transparency Directive. As to disclosure of control structures and transparency of beneficial disclosure, Italy deviates from the Transparency Directive’s minimum threshold of 5% for the first threshold reporting requirements.⁹⁹ In Italy, the first threshold is 2%, followed by 5%, and then increments of 5% up to 95% of holding.¹⁰⁰ However, Vermeulen indicates that countries such as Italy and Malaysia “have taken or are taking measures to amend the rules”¹⁰¹ by imposing a stricter threshold towards the international norm of 5% as the minimum starting threshold for reporting beneficial ownership. In addition, Italy’s securities regulator, CONSOB, appears to be moving towards a stricter disclosure regime. For example, CONSOB includes cash-settled equity derivatives in its reporting requirement, and mandates that the ultimate controlling person shall notify the major holding within five days of reaching a particular ownership threshold.¹⁰² CONSOB would ultimately verify the

⁹⁴ *Id.*; see also Fleischer and Schmolke, *supra* note 75, at 125-126 (discussing harmonization issues related to the Transparency Directive in general).

⁹⁵ Demarigny and Clerc, *supra* note 70, at XI; See also Fleischer and Schmolke, *supra* note 75.

⁹⁶ Demarigny and Clerc, *supra* note 70, at XI.

⁹⁷ *Id.*

⁹⁸ *Id.*; see also *id.* at XII-XIV (on recommendations for dealing with some of the above-mentioned issues).

⁹⁹ Vermeulen, *supra* note 30, at 20.

¹⁰⁰ *Id.* (citing the Italian Consolidated Law on Finance and the CONSOB, the Italian securities and regulatory agency).

¹⁰¹ *Id.*

¹⁰² *Id.* at 21.

reported information, post the information on its website, and ensure the data is publicly accessible.¹⁰³

In addition to the Mazars and Vermeulen studies, the 2013 *Global Witness Report* on G8 countries and hidden company ownership discovered that a public registry is an important criteria in assessing whether a country has high transparency of beneficial ownership disclosure. At the time of the *Global Witness Report*, nearly all G8 nations, including Italy, Germany, France and the United Kingdom, did not have a publicly accessible registry of company beneficial owners, though such data appeared to be retrievable privately or through a private registry.¹⁰⁴

In addition, Computershare's 2015 market analysis report on transparency of share ownership in six European nations¹⁰⁵ is worth noting, especially since transparency is defined in terms of whether *an issuer* (not a beneficial owner or shareholder) has visibility to the underlying beneficial owner of shares or can demand such disclosure. According to Computershare's study, by international standards, France, Germany, United Kingdom and Sweden are rated as being "highly transparent market[s] of share ownership for issuers,"¹⁰⁶ with issuers having a high degree of visibility into the beneficial owners and their shares. In each of these countries, visibility of beneficial ownership can be obtained through a shared register or through disclosure procedures under the law, as long as the shareholders are NOBOs (non-objecting beneficial owners). Comparatively, in Italy, issuers only have full transparency of investors at times of certain corporate actions such as annual general meetings.¹⁰⁷ However, Italian law does give a right to issuers to request that intermediaries disclose beneficial owners, as long as there are NOBOs and the issuer has adopted enabling by-laws allowing such disclosure.¹⁰⁸ Finally, Spain is largely classified as a bearer shares market (versus a registered shares market) with a "moderate level of transparency of share ownership for issuers due to the disclosure of Spanish intermediaries' client account holding".¹⁰⁹ Visibility of local investors is also higher than of foreign investors. At the same time, Article §497 of the Corporation Act

¹⁰³ *Id.*

¹⁰⁴ *Global Witness Report*, *supra* note 8, at 6.

¹⁰⁵ See generally Corney et al., *supra* note 56 (the six European nations included France, Germany, Italy, United Kingdom, Spain, and Sweden).

¹⁰⁶ *Id.* at 14-24 (analysing the European countries).

¹⁰⁷ *Id.* at 17.

¹⁰⁸ *Id.*

¹⁰⁹ *Id.*

gives issuers the right to request disclosure of beneficial ownership and, under Article §524 of the Corporation Act, “all intermediaries representing investors at shareholder meetings must disclose their clients’ voting instructions, and number of shares voted, to the issuer.”¹¹⁰

On balance, it appears that each of the jurisdictions discussed above has addressed the issue of transparency of beneficial ownership to some degree and that the EU Transparency Directive has contributed to an environment of greater disclosure of beneficial ownership. At the same time, according to the above-mentioned studies, there are some remaining issues and areas worth further research and reform since member nations do not have a fully harmonised procedure regarding transparency of beneficial ownership.¹¹¹ These will be discussed in a consolidated manner in Part VI of this article.¹¹²

III. U.S. INITIATIVES ON BENEFICIAL OWNERSHIP TRANSPARENCY

In the United States, the Securities Exchange Act of 1934 (the Securities Exchange Act) is the primary legislation that governs the disclosure and reporting of beneficial ownership and control structures for listed companies. In addition, the Foreign Account Tax Compliance Act of 2010 became effective as of 2014, and deals with foreign accounts in financial institutions with the goal of discovering the identities of anonymous beneficiaries of corporate vehicles. Finally and most recently, the United States seeks to fulfill the pledge of the 2013 G8 Summit’s action plan on beneficial ownership disclosure by passing the currently debated Incorporation Transparency and Law Enforcement Assistance Act (the “Levin Bill” or “ITLEAA”).

A. Securities Exchange Act of 1934¹¹³

Under Section 13(d) and 13(g) of the Securities and Exchange Act of 1934, the initial threshold for reporting is set at 5% ownership in a listed company, consistent with the EU Transparency Directive and international

¹¹⁰ *Id.* at 22.

¹¹¹ *See generally* Fleischer and Schmolke, *supra* note 75 (discussing whether full harmonization of the Transparency Directive is a necessary next step or even a viable option, weighing the pros and cons of such a move by the EU).

¹¹² *See* Part VI of this article (Outstanding Issues and Impact on Corporate Performance).

¹¹³ Securities Exchange Act of 1934, 15 U.S.C. 78(a) (2006); *see also* Securities and Exchange Commission, Beneficial Ownership Reporting Requirements and Security-based Swaps (SEC Release No. 34-64628, June 8, 2011).

norms. A person who is the beneficial owner of more than 5% of equity securities must disclose information related to such beneficial ownership within ten days of reaching the threshold.¹¹⁴ Rule 13d-3(a) defines beneficial owners as “persons who may, directly or indirectly, vote or dispose or direct the voting or disposition of a voting class of equity securities under section 12.”¹¹⁵ Furthermore, Section 13(d) and Schedule 13D require that the beneficial owner disclose extensive personal and professional information in regards to the purchased equity securities.¹¹⁶ Section 13(d)(2) and Rule 13d-2(a) impose a further obligation on the beneficial owner to report any material changes through a Schedule 13D amended filing. Under Rule 13d-2(a), a material change is deemed to be “the acquisition or disposition of beneficial ownership of securities in an amount equal to 1% or more of a class of securities,”¹¹⁷ though the Securities Exchange Commission (SEC) reserves the right to consider lesser acquisitions and dispositions as material based on facts and circumstances.¹¹⁸

One of the unique and important features of the Securities Exchange Act is that Rule 13d-3 allows for a case-by-case determination of whether a person is deemed to be a beneficial owner.¹¹⁹ This allows proportionality, flexibility and a “market practice”¹²⁰ approach in handling and integrating new financial arrangements under the existing law that may run afoul of the Securities Exchange Act, such as cash settled equity directives and security-based swaps.¹²¹ In addition, the SEC’s Electronic Data Gathering, Analysis and Retrieval System (EDGAR), stores, reports and analyses data regarding beneficial ownership and control information filed with the SEC.¹²² On most counts, EDGAR is publicly available.

¹¹⁴ Vermeulen, *supra* note 30, at 21.

¹¹⁵ *Id.* at 22.

¹¹⁶ *Id.*

¹¹⁷ *Id.*

¹¹⁸ *Id.*

¹¹⁹ *Id.* at 21 (citing Securities and Exchange Commission, Beneficial Ownership Reporting Requirements and Security-based Swaps (SEC Release NO. 34-64628, June 8, 2011)).

¹²⁰ *Id.* at 21, 26.

¹²¹ *Id.* at 22 (discussing section 766 of the Dodd-Frank Wall Street and Consumer Protection Act of 2010, which amended the Securities Exchange Act to add section 13(o) to deal with security-based swaps).

¹²² *Id.*

B. Foreign Account Tax Compliance Act of 2010¹²³

In addition to the Securities Exchange Act, the Foreign Account Tax Compliance Act of 2010 (FATCA), which came into effect in 2014, aims at discovering the identities of anonymous beneficiaries of corporate vehicles by targeting financial institutions and foreign accounts.¹²⁴ FATCA imposes an obligation on foreign U.S. persons and foreign entities to report any and all substantial U.S. ownership,¹²⁵ through shell companies and corporate vehicles, for instance,¹²⁶ to the Internal Revenue Service (IRS) and to foreign financial services. According to Greenberg, “the rules are intended to provide reporting both on accounts held directly by individuals and on interests in accounts held by shell entities for the benefit of U.S. persons.”¹²⁷ In addition, FATCA intends to “weed out” U.S. persons who may be hiding as anonymous beneficiaries of corporate vehicles.¹²⁸ Failure to comply with the reporting requirements of FATCA subject any non-complying institutions and beneficial owners to an almost 30% withholding tax.¹²⁹

C. Incorporation Transparency and Law Enforcement Assistance Act of 2013¹³⁰

A final noteworthy U.S. initiative towards mandating beneficial ownership disclosure is the Incorporation Transparency and Law Enforcement Assistance Act of 2013 (the “Levin Bill” or “ITLEAA”). The purpose of ITLEAA is “to ensure that owners and formation agents who for non-publicly held companies in the United States disclose the beneficial owners of those companies.”¹³¹ The reason for such mandatory disclosure is to prevent criminally minded individuals from creating and using corporate vehicles in the United States for illicit purposes, such as money laundering,

See Foreign Account Tax Compliance Act INTERNAL REVENUE SERVICE (Dec. 19, 2014), <http://www.irs.gov/Businesses/Corporations/Foreign-Account-Tax-Compliance-Act-FATCA>.

¹²⁴ *See id.*

¹²⁵ Biedermann, *supra* note 5, at 82 (citing 26 U.S.C. § 1473(2)(A) (2010), where “substantial United States Owner” means ownership of “more than 10 percent of the stock” in a corporation, rights to “more than 10 percent of the profits interests or capital interests” of a partnership, or indirectly or directly holding “10 percent beneficial interest” in a trust).

¹²⁶ *Id.*, at 81.

¹²⁷ Itai Greenberg, *The Battle over Taxing Offshore Accounts*, 60 UCLA L. REV. 304, 334 (2012).

¹²⁸ Biedermann, *supra* note 5, at 83.

¹²⁹ *Id.*, at 82 (discussing relevant provisions of FATCA).

¹³⁰ S. 569, 111th Cong. §2(3) (2009) (as introduced by Sen. Carl Levin, Mar. 11, 2009).

¹³¹ Kalant, *supra* note 3, at 1054.

tax evasion, and other illicit uses with shell companies.¹³² ITLEAA would impose an obligation on all U.S. states to maintain an accurate and updated list of all beneficial owners of corporations and LLCs created in the state, and to provide that list to law enforcement and others by subpoena or written request.¹³³

Three key features of ITLEAA are noteworthy and have led to controversial debates about whether it would effectively address the issues surrounding lack of transparency of beneficial ownership. First, ITLEAA would place a heavy burden on states and formation agents to collect and maintain an up-to-date list of all beneficial owners.¹³⁴ In addition, states must also provide an annual report that updates the state's list of beneficial owners.¹³⁵ Second, as part of maintaining such list, ITLEAA requires the state to "maintain a copy of driver's licenses of all such beneficial owners."¹³⁶ For foreign-held corporations in the U.S., ITLEAA requires that a formation agent certify the foreign application for incorporation in a U.S. state before the state will formally and legally accept the company.¹³⁷ As part of the certification process, beneficial owners of a foreign-held corporation or LLC must provide "a photocopy of the page of the government-issued passport on which a photograph of the beneficial owner appears."¹³⁸

ITLEAA imposes, arguably, onerous civil and criminal penalties on individuals and entities for failure to comply with the reporting requirements. For example, failure to provide correct beneficial ownership information or knowingly falsifying such information can result in a maximum fine of USD \$10,000 and up to three years in prison.¹³⁹

D. External Studies of U.S. Beneficial Ownership Transparency

The reports from external studies mainly center on an evaluation of current law and practices, namely the Securities Exchange Act. According to Vermeulen's comparative study of beneficial ownership disclosure across five jurisdictions, the United States "has clear, accessible, and also flexible

¹³² *Id.* at 1053-1054.

¹³³ Verret, *supra* note 51, at 859; S. 569, 111th Cong. §3(a)(1)(a)(1)(D) (2009).

¹³⁴ *See Id.*, at 859 (listing several burdens on states and formation agents); *see also* Kalant, *supra* note 3, at 1056 (stating "how and to whom the ownership information would be provided").

¹³⁵ Verret, *supra* note 51, at 859.

¹³⁶ *Id.*

¹³⁷ Kalant, *supra* note 3, at 1056-1057.

¹³⁸ *Id.*, at 1057; *see also* S. 569, 111th Cong. §3(a)(1)(a)(2)(B) (2009).

¹³⁹ Verret, *supra* note 51, at 859; S. 569, 111th Cong. §3(a)(1)(b) (2009).

rules that provide transparency in different layers of shareholding.”¹⁴⁰ It includes web-based access to EDGAR that “provides detailed and up-to-date information about listed companies, making it possible for companies to build a reputation as a competent and reliable investment opportunity.”¹⁴¹

Somewhat contrary to Vermeulen’s assessment, Computershare’s 2015 market analysis of transparency of share ownership (beneficial ownership) based on international standards rated the United States as providing “low transparency of share ownership for issuers due to the depository structure.”¹⁴² The U.S. central securities depository (CSD), the Depository Trust Company (DTC), places legal ownership in the name of its nominee, Cede & Co., which means that DTC-eligible U.S. securities “are registered to Cede & Co, significantly reducing the direct visibility of investors on the share register.”¹⁴³ Issuers can request the DTC to provide a list of beneficial owners under the law, but investors who hold securities through intermediaries may refuse to have their identity disclosed.¹⁴⁴ This is the case for institutional investors who are more commonly objecting beneficial owners (OBOs).¹⁴⁵ Furthermore, stock exchange-mandated fees for disclosure make the process of seeking beneficial ownership transparency cost-prohibitive.

Given that the FATCA was only recently implemented and it is not certain whether the ITLEAA will pass congressional approval, it is too early to assess the impact of both of these initiatives on company ownership disclosure. In addition, both FATCA and ITLEAA have garnered their share of criticism, which will be discussed in a consolidated manner in Part VI of this article.¹⁴⁶

IV. INTERNATIONAL EFFORTS AT MANDATING OWNERSHIP DISCLOSURE

Apart from the EU and U.S. initiatives in mandating disclosure of beneficial ownership, this section analyzes other international efforts aimed at creating greater transparency of beneficial ownership. While the issue of tax

¹⁴⁰ Vermeulen, *supra* note 30, at 29 (praising the flexibility and proportionality approach in the U.S. that allows for greater adaptability to technological evolution and further financial innovation with respect to tracking beneficial owners).

¹⁴¹ *Id.*

¹⁴² Corney et al., *supra* note 56, at 28.

¹⁴³ *Id.*

¹⁴⁴ *Id.*

¹⁴⁵ *Id.*

¹⁴⁶ See Part VI of this article (Outstanding Issues and Impact on Corporate Performance).

havens is not extensively discussed in this article, it is important to keep in mind that, according to several reports and studies, the largest culprits of avoiding disclosure of beneficial ownership requirements are off-shore tax havens such as the British Virgin Islands, Cayman Islands, Cook Islands and Singapore.¹⁴⁷

A. OECD Model Tax Convention

Despite criticisms to the contrary,¹⁴⁸ the OECD Model Tax Convention on Income and Capital (OECD Model Tax Convention) is regarded as providing “the prevailing international norms for a valid information request” between countries with respect to proliferating company information in foreign jurisdictions.¹⁴⁹

Article 26 of the OECD Model Tax Convention allows authorities to pursue claims against anonymous beneficiaries by placing a request for exchange of information with another treaty member state. The information request is valid so long as it is “foreseeably relevant” to the state’s domestic tax laws.¹⁵⁰ However, Article 26 also provides for several exceptions through which a treaty member state can refuse to comply with the request for exchange of information, including requests that: (a) would require the state to take actions or administrative measures that are contrary to state practice; (b) supply information that would not ordinarily be supplied under the laws of that state; and (c) disclose information that would contravene the state’s public policy.¹⁵¹ Because the language of these exceptions is so broad and all encompassing, it is difficult to understand how the OECD Model Tax Convention can serve as an effective, enforcement-based procedure for regulating the capture, analysis, reporting, and public transparency of beneficial ownership disclosure.¹⁵²

¹⁴⁷ Biedermann, *supra* note 5, at 87 (citing the Int’l Consortium of Investigative Journalists (ICIJ), *Offshore Leaks Database* (2013), available at <http://offshoreleaks.icij.org/search>); see also *Global Witness Report*, *supra* note 8, at 7-8 (listing tax havens where public registries of beneficial ownership do not exist).

¹⁴⁸ See Lee Sheppard, *Don't Sign OECD Model Tax Treaties!*, TAX JUSTICE NETWORK (May 31, 2013), <http://taxjustice.blogspot.com/2013/05/lee-sheppard-dont-sign-oecd-model-tax.html>.

¹⁴⁹ Biedermann, *supra* note 5, at 88

¹⁵⁰ *Id.*, at 78 (citing to OECD, *Update to Article 26 of the OECD Model Tax Convention and its Commentary*, 1 (2012), [http://www.oecd.org/ctp/exchange-of-tax-information/120718_Article%2026-ENG_no%20cover%20\(2\).pdf](http://www.oecd.org/ctp/exchange-of-tax-information/120718_Article%2026-ENG_no%20cover%20(2).pdf)); see also OLIVER R. HOOR, *THE OECD TAX CONVENTION: A COMPREHENSIVE TECHNICAL ANALYSIS* 233 (Legitech, 2010).

¹⁵¹ Biedermann, *supra* note 5, at 88.

¹⁵² *Id.* at 79 (discussing other provisions of the OECD Model Tax Convention and its potential limitations).

The leaders at the 2013 G8 Summit did support a revision to the OECD Model Tax Convention to require “an automatic exchange of information”¹⁵³ to obtain information more quickly and effectively on the beneficial ownership of “shell companies, special purpose companies, and trust arrangements.”¹⁵⁴ However, only eight nations are obligated to abide by the G8 Principles. While these nations do have strong influential reputations, the Convention has yet to be revised, and even if revised, it would have to be ratified and implemented by a significant portion of the signing member states. It is unlikely that member states would support an automatic exchange of information as this may tread on issues of state sovereignty and more importantly, because it would reduce the enormous benefits and competitive advantages that some jurisdictions likely enjoy from not disclosing beneficial ownership and control structures to the public.

B. Transparency of Beneficial Ownership in Asian Countries

Computershare’s March 2015 report on the results of a market analysis of transparency of share ownership to issuers focused, in part, on Asian countries including Australia, China, Hong Kong, India, and Japan.¹⁵⁵ In addition, Vermeulen’s 2012 comparative analysis of five jurisdictions and their beneficial disclosure regimes included China, Indonesia, and Malaysia.¹⁵⁶ Moreover, *Global Witness’* 2013 report on hidden company ownership briefly reviewed that state of public transparency into hidden company ownership in Hong Kong and Singapore.¹⁵⁷

By international standards, Australia is viewed as having a high level of transparency of shareholder information for issuers.¹⁵⁸ This is because Australia’s CSD, CHESS, is structured based on direct legal title. In addition, laws in Australia give legal rights to listed companies (issuers) to obtain information on their beneficial owners.¹⁵⁹ A share register, consisting of two sub-registers, is updated and provided to the issuer at the end of each day. The complete share register is available for public inspection. With respect to

¹⁵³ 2013 Lough Erne G8 Leaders’ Communiqué, GOV.UK 6-7 (June 18, 2013), https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/207771/Lough_Erne_2013_G8_Leaders_Communique.pdf.

¹⁵⁴ Biedermann, *supra* note 5, at 88.

¹⁵⁵ See Corney et al., *supra* note 56.

¹⁵⁶ Vermeulen, *supra* note 30, at 25-27 (discussing disclosure of beneficial ownership with respect to control structures, control-enhancing mechanisms and arrangements and corporate vehicles).

¹⁵⁷ *Global Witness Report*, *supra* note 8, at 5-6.

¹⁵⁸ Corney et al., *supra* note 56, at 4.

¹⁵⁹ *Id.*

nominee accounts with an intermediary, issuers can demand that the nominee disclose beneficial owners under Section 672 of the Corporations Act of 2001.¹⁶⁰

While China is still considered to be a primarily domestic market with “government entities holding a controlling interest in many public companies,”¹⁶¹ by international standards, Computershare’s study grades China as “a highly transparent market of share ownership for issuers.”¹⁶² This is because all shares are registered in a state-controlled central registrar where issuers are able to receive a list of all shareholders “on a monthly basis free of charge.”¹⁶³ According to the Law of the People’s Republic of China on Securities (China Securities Law), a listed company must disclose detailed information about beneficial ownership (those holding 5% or more) and voting rights both in semi-annual and annual reports.¹⁶⁴ Under Article 3 of the Administrative Measures on Information Disclosure by Listed Companies, there is an affirmative obligation on company directors to ensure the accuracy and completeness of any information disclosed, which is further reinforced by the duty of company directors to sign and certify regular reports under Article 24.¹⁶⁵ Moreover, listed companies must report information of beneficial ownership and control structure to their respective stock exchanges as well as to the China Securities Regulatory Commission.¹⁶⁶ Thus, China requires a great deal of disclosure from companies, which seems appropriate given how many companies are state-controlled.

Similar to China, India is considered to be a predominantly domestic market.¹⁶⁷ By international standards, India is a “particularly high transparency market of share ownership for issuers.”¹⁶⁸ Share ownership can be in the form of registered and certified shares listed on a share register, or held in a dematerialized form by an intermediary in two central depository

¹⁶⁰ *Id.*

¹⁶¹ *Id.* at 6.

¹⁶² *Id.* (discussing the differences in B-shares and Qualified Foreign Institutional Investor (QFII) scheme specifically for foreign investment in China).

¹⁶³ *Id.* (noting that, with respect to QFII foreign shareholders, the registered owner is more often a financial intermediary so the issuer “has no mechanism to obtain the beneficial ownership beyond this level”).

¹⁶⁴ Vermeulen, *supra* note 30, at 25.

¹⁶⁵ *Id.*

¹⁶⁶ *Id.* at 26.

¹⁶⁷ Corney et al., *supra* note 56, at 10.

¹⁶⁸ *Id.* (noting also that India, similar to China, has implemented the Qualified Foreign Institutional Investor (QFII) program specifically for foreign investors in India).

services.¹⁶⁹ Indian law gives beneficial owners the legal rights in the shares purchased, without the need for intermediaries to have legal rights.¹⁷⁰ This allows for “direct visibility and a direct legal relationship between the issuers and their beneficial owners...”¹⁷¹ Furthermore, under the Companies Bill of 2012, a full list of beneficial owners is filed with the stock exchange, after each annual general meeting, and with the Registrar of Companies.¹⁷² Anyone can access the list of beneficial owners upon reasonable notice and payment of a nominal fee.¹⁷³

However, since India has adopted the Qualified Foreign Institutional Investor programme (QFII), there is less visibility into foreign beneficial ownership.¹⁷⁴ Both India and China would do well to reconsider the need for a QFII regime as their markets develop, especially if they wish to reach their full potential. In the alternative, changes to the QFII regime to allow for greater access and visibility into foreign beneficial ownership may be warranted, as seems to be the case concerning the legislative intent underlying U.S. ITLEAA, discussed in Part IV(c) of this article.

Japan is considered as providing “moderate to low transparency of share ownership” to issuers.¹⁷⁵ First, while investors can directly register their shares with the issuer’s share register, this is not common practice.¹⁷⁶ Most investors are institutional investors who use nominee accounts, such as custodial or omnibus accounts, through intermediaries.¹⁷⁷ Only the nominee or omnibus account information (i.e., intermediary account) is listed on the issuer’s share register as the legal shareholder, thus precluding disclosure of beneficial ownership.¹⁷⁸ While issuers do receive information about all nominee accounts from Japan’s Security Depository Center (SDC) twice per year and the account details may disclose the underlying beneficial owner, this practice is not consistent,¹⁷⁹ and high fees preclude more frequent updates and reporting requests.¹⁸⁰ Second, similar to China and India but without having a formal QFII program, securities for foreign investors in

¹⁶⁹ *Id.*

¹⁷⁰ *Id.*

¹⁷¹ *Id.*

¹⁷² *Id.*

¹⁷³ *Id.*

¹⁷⁴ *Id.*

¹⁷⁵ *Id.* at 12.

¹⁷⁶ *Id.*

¹⁷⁷ *Id.*

¹⁷⁸ *Id.*

¹⁷⁹ *Id.*

¹⁸⁰ *Id.*

Japan are held and “recorded through a foreign intermediary, who holds legal title to the shares,”¹⁸¹ thus reducing visibility to foreign beneficial owners. Japan’s beneficial ownership disclosure regime could certainly benefit from some reforms.

Similar to India, Hong Kong is a “highly transparent market of share ownership for issuers,”¹⁸² primarily because Hong Kong law supports an issuer’s right to disclosure of beneficial ownership in listed companies.¹⁸³ Investors can hold shares directly through a certified form for registered shares or via an intermediary in Hong Kong’s CCASS, a transparent depository that permits public disclosure on Hong Kong’s stock exchange. With respect to issuers’ right of disclosure, under Section 329 of the Securities and Futures Ordinance (Cap 571), issuers can compel the intermediary to disclose the underlying beneficial owners, even those who are represented in a chain of beneficial owners.¹⁸⁴ In a further step towards transparency, issuers also notify the stock exchange and the Securities and Futures Commission of any disclosure requests,¹⁸⁵ the findings of which are publicly available on the Hong Kong Stock Exchange website.

Finally, Vermeulen’s study reveals Malaysia as “offering a high level of disclosure and reporting”¹⁸⁶ with a beneficial ownership disclosure regime that is “very extended and detailed”¹⁸⁷ and includes “easy electronic access to ownership and control information.”¹⁸⁸ Minority investors and the public can find information about shareholders “as far as the final layer of beneficial owners,”¹⁸⁹ as long as the shareholder is a “substantial shareholder,” meaning that the shareholder “holds, either directly or indirectly, at least 5% of the outstanding shares.”¹⁹⁰

Under the Malaysian Companies Act (amended in 2006), companies have several obligations with respect to disclosure of beneficial ownership.

¹⁸¹ *Id.*

¹⁸² *Id.* at 8; *Cf. Global Witness Report, supra* note 8, at 6 (stating that Hong Kong does not have a register [public or private] of beneficial ownership).

¹⁸³ Corney et, al., *supra* note 56, at 8.

¹⁸⁴ *Id.*

¹⁸⁵ *Id.* (citing to Section 330 of the Securities and Futures Ordinance and noting that disclosure of beneficial owners is more difficult for those beyond Hong Kong’s jurisdiction due to lax enforcement and penalties for non-compliance on disclosure requests).

¹⁸⁶ Vermeulen, *supra* note 30, at 26.

¹⁸⁷ *Id.*

¹⁸⁸ *Id.*

¹⁸⁹ *Id.*

¹⁹⁰ *Id.* (citing Section 69D of the Malaysian Companies Act (last amended in 2006).

Under Section 158, companies must keep and maintain a detailed register of their members and the number of shares they hold, which is public and is “open to inspection by any member free of charge.”¹⁹¹ In addition to the general shareholder register, Section 69C requires companies to maintain a separate register containing only the substantial shareholders, including any changes in shareholding position as well as a detailed explanation of the change.¹⁹² Moreover, a similar obligation rests with the shareholder, who has a duty to notify the company when, if ever, he or she became a substantial shareholder.¹⁹³

Under the Listing Requirements of Bursa Malaysia Securities Berhad (Listing Requirements), a listed company must: (i) announce notices related to substantial shareholdings;¹⁹⁴ (ii) announce any changes of control in the company;¹⁹⁵ and (iii) identify substantial shareholders in its annual report¹⁹⁶ along with other details regarding the substantial shareholders and direct interests. These company announcements are submitted to and available through Bursa Malaysia Listing Information Network (Bursa LINK), which enables providers, investors and regulators “to instantly obtain information about beneficial ownership and control structures.”¹⁹⁷

A third and important aspect of Malaysia’s beneficial ownership disclosure regime is the Securities Industry Central Depositories Act 1991 (SICDA). Under SICDA, every securities account must be opened “in the name of the beneficial owner... or in the name of the authorized nominee.”¹⁹⁸ Where the account is opened in the name of the authorized nominee, SICDA Rule 25.02B(2) requires that the authorized nominee (intermediary) stipulate the identity of the beneficial owner and relevant details about the beneficial owner. Further information can also be requested by numerous regulatory agencies. The authorized nominee can face revocation to act as nominee account holder as well as suspension from all managed accounts for failure to comply with the disclosure requirements. Furthermore, the nominee companies and custodians who operate omnibus accounts are also required to

¹⁹¹ *Id.* (citing to Section 160(2) of the Malaysian Companies Act).

¹⁹² *Id.* at 24 (discussing Section 69L of the Malaysian Companies Act).

¹⁹³ *Id.* (citing to Section 69E of the Malaysian Companies Act).

¹⁹⁴ *Id.* (citing Paragraph 9.19(17) and (18) of Malaysia’s Listing Requirements).

¹⁹⁵ *Id.* (citing Paragraph 9.19(41) of Malaysia’s Listing Requirements).

¹⁹⁶ *Id.* (citing Paragraph 23, Appendix 9C of Malaysia’s Listing Requirements).

¹⁹⁷ Vermeulen, *supra* note 30, at 25.

¹⁹⁸ *Id.* (citing Section 25(4) of the Securities Industry (Central Depositories Act) 1991 (SICDA)).

disclose beneficial owners¹⁹⁹ upon request by the Securities Commission of Malaysia, subject to criteria under Section 45 where disclosure is permitted without violating the beneficial owner's consent.²⁰⁰

As compared with many jurisdictions, Malaysia does, indeed, appear to have one of the most comprehensive and detailed beneficial ownership disclosure schemes. Some might even say that this scheme is too complex and burdensome on the listed company and beneficial owners. This leads to a larger question of how strict or how flexible should a beneficial ownership disclosure regime be. While this is not the direct focus of this article, in the case of Malaysia, Vermeulen points out that before the 1997-1998 Asian financial crisis, Malaysia had very simple and basic rules on beneficial ownership.²⁰¹ In response to the Asian financial crisis, Malaysia went to the opposite extreme and enacted detailed, extensive and rather strict laws, which may have restored investor confidence for a short time but also "negatively affected Malaysia's reputation and attractiveness... to foreign investors."²⁰² This led to Malaysia's initiative to implement reforms in 2005 to "relax and streamline the regime."²⁰³ Whether those efforts are successful remains to be seen. One could argue that Malaysia's current regime faces some of the same issues as other jurisdictions, where there is no public register of beneficial ownership combined with a cost-heavy and resource-intensive compliance and enforcement system.²⁰⁴

V. OUTSTANDING ISSUES, POLICY RECOMMENDATIONS, AND IMPACT ON CORPORATE PERFORMANCE

A. Outstanding Issues and Policy Recommendations

From the above analysis, there is some room for relief and celebration in knowing that jurisdictions are concerned with the impacts of hidden company ownership, and serious about implementing measures to increase transparency of the disclosure and findings of company beneficial ownership. However, as we look back on the commitments at the 2013 G8 Summit, the issue has not yet reached effective resolution. In the wake of ever-increasing innovation in the financial sector coupled with the

¹⁹⁹ *Id.*

²⁰⁰ *Id.*

²⁰¹ *Id.* at 26.

²⁰² *Id.*

²⁰³ *Id.*

²⁰⁴ *Id.* at 46 (discussing Malaysia's public enforcement system as compared with an informal public or private enforcement systems).

imaginative creation corporate vehicles for personal as well as sometimes illicit gain, outstanding issues remain.

1. *Defining Ownership*

The first and most foundational issue is defining terms such as 'ownership,' 'beneficial ownership,' 'control' and 'transparency,' as they relate to issues of implementing an effective disclosure and transparency regime for hidden company ownership. As discussed in the preliminary sections of this article, there are myriad definitions of ownership, but it is most commonly referred to as beneficial ownership. However, there are multiple definitions of beneficial ownership, such as the potentially contradictory definitions in the U.S. Securities Exchange Act, which focuses on 'voting power' and 'investment power,' as compared to U.S. proposed ITLEAA, which focuses on the degree of 'control' of a shareholder.²⁰⁵ Another example is the EU Transparency Directive's use of 'power to exercise dominant influence or control' versus Malaysia's use of 'substantial shareholder.' Moreover, while the majority of jurisdictions have adopted the international norm of 5% initial threshold as the mark of "beneficial ownership," Russia uses "more than 1% of shares in a company" as the delimiter on whether a shareholder is important enough to review the share register or vote. Perhaps it is time to establish a more consistent, cross-border definition for the problem that mandatory company ownership disclosure is intended to solve, based on the goals to be obtained by mandating such information.

Vermeulen argues that a disclosure and enforcement regime could be devised to target different types of beneficial owners, such as: "(1) passive beneficial owners who are only interested in a company's share price, (2) beneficial owners who monitor the performance of listed companies and initiate dialogues with management, and (3) beneficial owners that seek to acquire control over a listed company."²⁰⁶ If such distinctions do exist, and shareholders do have different functions and rationales for acquiring equity securities, it makes sense to adopt a clear, comprehensive, yet concise

²⁰⁵ Verret, *supra* note 51, at 863 (discussing a major criticism of the Levin Bill in mixing concepts of ownership and control: "One would be a focus on owners, the other a focus merely on those individuals or owners who actually control the company. The latter offers a clearer view of those who might be using the entity for illegal purposes, and yet, defining control...is a particularly difficult task").

²⁰⁶ Vermeulen, *supra* note 30, at 17.

definition of ownership to accommodate these functions, and to harmonise these terms and definitions across jurisdictions.

In addition, by reviewing the statutory interpretation of nearly all definitions of “beneficial ownership,” one of the main concerns is to manage those who would be considered inside blockholders with the intention to control the company. Delineating the definition of beneficial ownership down to purposeful definitions would certainly reduce the costs of gathering and verifying information, enhance the ability for generating useful reports on company ownership, increase the likelihood that law enforcement and regulatory agencies can intervene where illicit activity occurs, and more importantly, provide transparency of communication and decision-making.

2. Defining Transparency

A second outstanding yet foundational issue is the need for greater clarity and consensus on the definition of transparency, especially with respect to the level of transparency necessary to have an effective beneficial ownership disclosure and enforcement regime.

Disclosure and transparency, as used in this article, can have different meanings. At the national level, companies and regulatory agencies may compel disclosure of beneficial ownership information; however, whether such information is transparent to the degree necessary to prevent the issue of hidden company ownership is a different matter. As analysed in Part II(C) of this article, transparency, to date consists of at least three different components: (i) transparency to the issuer through required disclosures under national law by investors who reach certain ownership thresholds; (ii) transparency to the issuer through disclosures under national law by intermediaries who hold securities for investors and who must respond to formal disclosure requests; and (iii) transparency to the general public, international regulatory agencies and law enforcement about beneficial owners in companies.²⁰⁷

Moreover, because companies today operate in a global economy, the degree of transparency required by bodies of international trade, such as the World Trade Organization (WTO), must be taken into account. The WTO’s glossary defines transparency as “the degree to which trade policies and practices, and the process by which they are established, are open and

²⁰⁷ See Part II(c) of this article.

predictable.”²⁰⁸ In effect, according to Martinez-Fraga, a general principle of transparency in international law “suggest[s], if not altogether commands... a universal absence of concealment.”²⁰⁹

By applying the above definitions to beneficial ownership disclosure policies and practices, as well as the process by which they are determined, it is clear that the international community has a long way to go with respect to meeting the high standards of transparency indicated above, especially in terms of predictability.²¹⁰ At the same time, transparency will not create a climate of openness and predictability if there is asymmetrical information or policies and rules that nobody understands,²¹¹ especially those tasked with complying with such rules, analysing the data, or enforcing the laws that require disclosure of the information. Under this understanding of transparency, studies show that most countries have national legislation aimed at disclosure of beneficial ownership information by investors and intermediaries to the issuer. Such disclosures are subject to a formal request and sometimes at a high cost, and only by the issuer to the national regulatory and monitoring agencies. What is missing is a consistent and up-to-date national and international public registry of beneficial company ownership.

The May 2014 G20 Position Paper highlights several advantages of a public registry of beneficial company ownership as a means to accomplish transparency goals, including but not limited to: (i) reducing the red-tape in law enforcement in conducting cross-border investigations so that there is less likelihood that money-launderers have advance warning to shift assets quickly; (ii) serving as a cost-effective way to enforce financial crimes legislation; (iii) allowing investors to know company ownership players in order to facilitate honest trade and make informed decisions on investments; and (iv) building greater trust among civil society in the battle to combat crime and corruption.²¹² To accomplish this requires an international

²⁰⁸ Avnita Lakhani, *The Role of Transparency in the Harmonization of Commercial Law*, 19.1 THE VINDOBONA J. OF INT'L COM. L. AND ARB. 93 (2015) (citing T. Collins-Williams and R. Wolfe, *Transparency as a trade policy tool: the WTO's cloudy windows*, 9(4) WORLD TRADE REV. 551 (2010)).

²⁰⁹ Lakhani, *supra* note 211, at 93 (citing P. J. Martinez-Fraga, *Juridical Convergence in International Law Dispute Resolution: Developing a Substantive Principle of Transparency and Transnational Evidence Gathering*, 10 LOY. U. CHI. INT'L L. REV. 37, 66, 69-70 (2012)).

²¹⁰ The issue of predictability was highlighted in Mazars' assessment of the EU Transparency Directive. Demarigny and Clerc, *supra* note 85, at XVIII.

²¹¹ Lakhani, *supra* note 211, at 94.

²¹² *G20 Position Paper: Transparency of Legal Entities and Arrangements*, TRANSPARENCY INTERNATIONAL 2 (May 2014), <https://www.transparency.it/wp->

consensus on the levels of company ownership based on function and intention, as well as a consensus on the exact threshold of beneficial ownership that should trigger legal and policy actions to prevent illicit use of corporate vehicles, trusts, control structures, and other arrangements. For example, it is possible that the norm of 5% initial threshold to trigger beneficial ownership reporting is too cumbersome, costly and ineffective for the purposes of monitoring a shareholder whose intention is to control the company,²¹³ especially considering that only a 2% (as in Malaysia) or 1% (as in Russia) initial threshold is necessary to monitor corruption and money-laundering. In short, a more nuanced, targeted approach would yield more effective outcomes.²¹⁴ A nuanced and targeted regime would also reduce the fear of engaging in positive and legitimate shareholder activities aimed at monitoring management performance, facilitating genuine shareholder activism, reducing horizontal and vertical agency costs, and encouraging stability in share price and company valuation.

3. *Understanding the Impact of Corporate Vehicles*

A third outstanding issue is the need for more focused research, understanding, and regulation regarding the impact of trusts, nominee accounts, omnibus accounts, cash-settled derivatives, cash-settled swaps and control-enhancing mechanisms, and arrangements on hidden company ownership. As evidence by the aforementioned studies and analysis in previous sections, there are extensive use of trusts, nominee accounts, omnibus accounts and control-enhancing mechanisms in each jurisdiction.

content/uploads/2014/05/TI-G20-Position-papers-Beneficial-Ownership.pdf; Cf. Verret, *supra* note 51, at 890-91 (discussing the legitimate business privacy needs for keeping control structures and beneficial ownership out of the public realm, something which the U.S. Levin Bill would allegedly jeopardise by increasing the costs to maintain business privacy, especially given the Freedom of Information Act and the right-to-know laws in nearly 40 states in the U.S.); *see generally* 76 C.J.S. Records § 113 (2009); 37A Am. Jur. 2d Freedom of Information Acts § 56 (2010); Backer, *supra* note 62, at 4 (discussing how transparency can increase “legitimacy (norm) and accountability (technique) among stakeholders”).

²¹³ *See, e.g.*, Fleischer and Schmolke, *supra* note 96, at 126-28 (discussing how, despite the 5% threshold set in the EU Transparency Directive, EU member nations are not following this notification threshold and some are even imposing additional notification thresholds not included in the Directive, thus leading to lack of harmonization in applying the Transparency Directive).

²¹⁴ *See, e.g.*, Vermeulen, *supra* note 30, at 16-17 (discussing the disadvantages of a strict disclosure regime).

A 2011 World Bank study found trusts to be the second largest vehicle behind corporations to be used for corruption.²¹⁵ In addition, one of the biggest criticisms of the U.S. proposed ITLEAA legislation is that it fails to require disclosure and tracking of beneficial ownership information from trusts, foundations, non-profit organisations and other legal structures, which are used for illicit financial gain and for fostering financial crimes.²¹⁶

In the case of nominee accounts, a nominee shareholder creates “a company... for the purpose of holding shares and other securities on behalf of investors.”²¹⁷ Shares and other securities are held in trust for the actual beneficial owner.²¹⁸ For foreign investors, in most jurisdictions, shares and securities may only be held through a nominee account in a foreign intermediary because the foreign shareholder is now allowed to participate directly or register directly with the local jurisdiction’s central securities depositories. Thus, at the local level, only the nominee account holder’s name appears on the issuer’s share register, which would provide an opportunity to beneficial owners, though sometimes unintentionally in the case of foreign investors, to shield their identity and make it more difficult to control expropriation by controlling shareholders.²¹⁹

Similarly, there are serious issues with concealing identities of beneficial owners through omnibus accounts. An omnibus account is opened in the name of the account provider and serves “as an umbrella securities account covering a large number of individual accounts.”²²⁰ While omnibus accounts help in reducing transaction costs, issuers only show the primary account holder (intermediary) on the share register, thus reducing visibility of the breakdown of beneficial owners behind omnibus accounts.

In addition, the use of derivatives and related techniques, such as cash-settled equity derivatives and cash-settled swaps, are yet another way to reduce, or avoid altogether, the disclosure of beneficial owners. Cash-settled derivatives are used “to obtain effective control of the underlying shares

²¹⁵ *G20 Position Paper*, *supra* note 215, at 2 (citing Stolen Asset Recovery Initiative, *Puppet Masters: how the corrupt use legal structures to hide stolen assets and what to do about it*, WORLD BANK (2011)).

²¹⁶ Verret, *supra* note 51, at 873.

²¹⁷ Vermeulen, *supra* note 30, at 12; *see* Corney et al, *supra* note 56, at 35.

²¹⁸ Vermeulen, *supra* note 30, at 12.

²¹⁹ Note: As indicated in the above sections, most jurisdictions can compel disclosure of the beneficial owners under nominee and omnibus accounts by filing a formal request with the intermediary; however, there are fees for such requests, which may deter some issuers with large shareholders.

²²⁰ Vermeulen, *supra* note 30, at 12; *See* Corney et. al., *supra* note 56, at 35.

without the need for disclosure...”²²¹ The cash-settled swap agreement essentially “results in a decoupling of the voting rights from the beneficial ownership of the shares...lead[ing] to ‘hidden ownership’ and ‘empty voting’ issues.”²²² Hidden ownership allows an investor to maintain an *undisclosed* “long position in the shares of a listed company... until the investor physically acquires the shares”²²³ or settlement is finalised.

While the UK and France have already taken steps to combat hidden ownership issues, and other EU member states such as Italy, the Netherlands and Portugal are discussing solutions,²²⁴ there is no EU-wide or even international solution to the ramifications of “hidden ownership” at this stage. In empty voting scenarios, the voting “occurs when the shareholder on record date is no longer the economic owner when the vote closes”²²⁵ as in the case where there is a long period of time between a company’s annual meeting date when voting occurs and the record date. According to Hu and Black, “empty voters” are “persons whose voting rights substantially exceed their net economic ownership.”²²⁶ Despite this, the derivatives broker “votes the shares as directed by the investor.” According to Schouten and confirmed by a variety of scholars, empty voting can pose a serious threat or undermine the decision-making process in shareholder meetings.²²⁷ Empty voting issues may be combined with over-voting²²⁸ or negative voting to distort or mask the identity of beneficial owners as well as impair legitimate decision-making processes within a listed company.

Finally, control-enhancing mechanisms such as shareholder agreements, pyramid ownership structures, and cross-holding ownership structures²²⁹ are designed to give controlling investors voting/control rights in excess of their cash-flow rights,²³⁰ in part by separating voting rights from

²²¹ Vermeulen, *supra* note 30, at 13.

²²² *Id.*

²²³ *Id.*; see Schouten, *supra* note 12, at 160-70 (discussing the issues with hidden ownership).

²²⁴ Fleischer and Schmolke, *supra* note 96, at 128.

²²⁵ Corney et al, *supra* note 56, at 35; See Schouten, *supra* note 12, at 170-75 (discussing the issues with empty voting).

²²⁶ Schouten, *supra* note 12, at 170 (citing Hu and Black, *supra* note 13, at 825).

²²⁷ *Id.* at 171-175 (discussing the issues with empty voting); See also Jonathan Cohen, *Negative Voting: Why It Destroys Shareholder Value and a Proposal to Prevent It*, 45 HARV. J. ON LEGIS. 237, 237-49 (2008); Shaun Martin & Frank Partnoy, *Encumbered Shares*, 2005 U. ILL. L. REV. 775, 775 (2005).

²²⁸ Corney et al, *supra* note 56, at 35.

²²⁹ Vermeulen, *supra* note 30, at 13-14.

²³⁰ *Id.*

cash-flow rights.²³¹ Pyramid structures are used extensively in Europe and, until recently, in Asian countries, though there is a declining trend in Asia because of legislation's efforts in preventing such use.²³² Such structures are used "to allow shareholders to retain substantial voting power"²³³ while reducing liquidity constraints. Control-enhancing mechanisms not only reduce visibility of beneficial ownership but, according to empirical studies, such mechanisms impose a negative impact on firm value.²³⁴ A heightened sense of policy imperatives needs to be aimed at understanding and improving the transparency of beneficial ownership in these various arrangements.

4. Use of Technology

The final outstanding issue, resolution to which can make a big impact on achieving the goals of public transparency of beneficial ownership, is making greater and more strategic use of technological innovations to automate the process of receiving, verifying, analyzing, and reporting beneficial ownership information.²³⁵

As evidenced by the analysis of the jurisdictions in the aforementioned studies, each jurisdiction has their own technology platform and procedures for recording beneficial ownership information, even including websites to share that information as part of a national and private register. However, the studies point to unreasonable inefficiencies in the processes for capturing, verifying and reporting on this data. There are also unnecessary complexities in the overall beneficial disclosure and enforcement

²³¹ *Id.*; see Schouten, *supra* note 12, at 138-39; Lucian A. Bebchuk et al., *Stock Pyramids, Cross-Ownership, and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control From Cash-Flow Rights*, CONCENTRATED CORPORATE OWNERSHIP 20 (R. Morck ed., Univ. of Chicago Press 2000); Sanford Grossman and Oliver Hart, *One Share-One Vote and the Market for Corporate Control*, 20 J. FIN. ECON. 175, 175 (1988).

²³² Vermeulen, *supra* note 30, at 13-14, 34-36 (discussing the use of pyramid ownership structures in Europe generally, Italy, China, Indonesia and other Asian countries as well as its decline in some nations because of legislation banning it).

²³³ *Id.* at 13; see also Verret, *supra* note 51, at 869-70 (discussing stock pyramids and cross holdings, two types of ownership that would "significantly complicate the beneficial ownership reporting approach" under ITLEAA in particular).

²³⁴ P. Limpaphayom, *The Effect of Ownership Structure on the Relation between Corporate Governance and Firm Value in Thailand* (paper presented at the OECD-Indonesia Policy Dialogue: Disclosure of Beneficial Ownership and Control, Bali, 5 October 2011).

²³⁵ See, e.g., Demarigny and Clerc, *supra* note 85, at XVI (stating with reference to the EU Transparency Directive, "Two years after the introduction of the Directive, there would still not appear to be a stable and consensual vision on the manner in which stored information may be accessed at national and EU level [sic]").

regime by the continuing use of manual forms,²³⁶ including the issuer's considerable expenses in requests for disclosure of beneficial owners, , irregular updating of information, lack of sufficient technology infrastructure for consistent reporting, and having to submit multiple disclosure requests for chain of corporate vehicles hiding beneficial owners.

Today, technological innovations such as cloud-based systems, mobile technology, and security-enabled encryption services can be used to automate the process of receiving, verifying, updating, analyzing and reporting beneficial ownership data on an international scale. Both in theory and in practice, a "one-stop-shop for disclosure of beneficial ownership information" is possible. This can serve as the foundation of a global public register, which creates trust among the investment community and ensures that those who seek to engage in illicit activity through hidden company ownership have a strong deterrent to doing so.

B. Impact on Corporate Performance

With respect to whether mandatory disclosure of beneficial company ownership, which is made publicly transparent, has an impact on corporate performance, Mazars's assessment on the EU Transparency Directive seems to answer this in the negative. According to Mazar's analysis, 69% of shareholders "do not consider the compliance cost with periodic information obligations to be too onerous."²³⁷ Issuers subject to the EU Transparency Directive's ownership disclosure obligations also tend to "publish more than the minimum requirements regarding half-yearly and quarterly financial information."²³⁸ Perhaps this explains why 82% of respondents felt that the published information was useful in making investment decisions and 70% of stakeholders had positive comments about the quality of the published information, stating that it was "pertinent to making an informed assessment as to the financial position of the issuer."²³⁹ Furthermore, 58% of stakeholders stated that the notification of major holdings requirement under

²³⁶ See *id.* at XVIII (stating that "66% of non-EU stakeholders would favour a common electronic form for the notification of major holdings...[while] 89% support the idea of a central EU access point to information stored by EU-listed issuers"). It is thus reasonable that other jurisdictions would support similar initiatives.

²³⁷ *Id.* at IX.

²³⁸ *Id.* at IX.

²³⁹ *Id.*

the Directive “do not result in an unreasonable increase of burden on the company.”²⁴⁰

At the same time, there was a consensus that the timing of disclosure requirements should take into account the needs of SMEs and impact on its company performance in meeting the ownership disclosure obligations.²⁴¹ In addition, while the periodic reporting requirements enhance accountability and provide certain confidence to investors, there is no regime to ascertain whether false or misleading information has been disclosed.²⁴² If this important verification process were triangulated like information in a scientific field, it would better serve the legislative intent and purpose of the EU Transparency Directive.

Fleisher and Schmolke also highlight that the regime on disclosure of major shareholdings is severely impacted by the high level of fragmentation across the twenty-seven member states of the EU in adopting and implementing the Transparency Directive, leading to “significant costs on the investor.”²⁴³ For a listed company that is an institutional investor, it would certainly impact corporate performance to the extent that these costs cut into other important development priorities and income streams. As a listed company (both EU and non-EU), having to follow different notification thresholds across twenty-seven jurisdictions (not to mention the different methods of notification and levels of information) will certainly increase compliance costs for the company.²⁴⁴ This fragmentation may ultimately “give rise to a tangible threat of significant distortions of competition in the market for corporate influence and control.”²⁴⁵ Under the minimum ownership disclosure requirements and thresholds of the Transparency Directive, EU member states can impose requirements that are more stringent and create an environment of regulatory competition among EU member states.²⁴⁶ This is neither effective nor efficient in terms of overall competition between EU companies and non-EU entities.

²⁴⁰ *Id.* at XI.

²⁴¹ *Id.* at X.

²⁴² *Id.*

²⁴³ Fleischer and Schmolke, *supra* note 96, at 128.

²⁴⁴ *Id.* at 136-37 (“The Transparency Directive II [2004] has failed in its key task of simplifying the disclosure process across the EU and reducing compliance costs”).

²⁴⁵ *Id.* at 132-33 (citing this concern as a reason for invoking full harmonisation of the Transparency Directive under Article 114(1) of the TFEU, especially the transparency requirements for major shareholdings).

²⁴⁶ Niamh Moloney, EC SEC. REG. 10 (2d ed., 2008).

While the EU Transparency Directive generally receives positive responses from stakeholders, the US ITLEAA bill will negatively affect company performance and potentially trample on business privacy. The largest negative impact is compliance cost. For example, existing businesses, especially small businesses, will incur significant costs in meeting the ownership disclosure requirements because they will need to procure resources to keep up-to-date records and make additional provisions to ensure access to this data by law enforcement and regulatory agencies.²⁴⁷ New companies, both domestic and foreign, will suffer the same costs. In addition, state governments will incur non-subsidized costs for “hardware, software, and personnel required to collect, preserve, and make publicly available”²⁴⁸ the beneficial ownership information for thousands of business entities across the state.

The second negative impact, perhaps more important, is the Levin Bill’s potential to “change the competitive position of publicly held companies versus privately held companies.”²⁴⁹ Foreign governments, or even foreign companies in foreign nations, may request such information and use that information to “enhance their competitive position against U.S. companies”²⁵⁰ or use that information in furtherance of illicit activities, to avoid law enforcement, or to exploit such information for unlawful gain or competitive advantage.

Finally, as discussed previously, disclosure of beneficial ownership information may negatively affect the decision-making processes of a company. Controlling shareholders as well as minority shareholders are not able to objectively assess management performance and guide the company towards achieving shareholder value without recriminations.

Overall, despite potential concerns about the impact of beneficial ownership disclosure on corporate performance, a disclosure regime shall still

²⁴⁷ See Verret, *supra* note 51, at 876 (citing HM Treasury & Dep't of Trade and Indus., Regulatory Impact Assessment on Disclosure of Beneficial Ownership of Unlisted Companies 16 (2002), http://www.hm-treasury.gov.uk/d/beneficial_condoc.pdf (discussing the costs of compliance of a beneficial ownership disclosure regime to an average UK company). Similar concerns were expressed during U.S. congressional discussions on the impact of ITLEAA to businesses in the U.S.

²⁴⁸ *Id.* at 861 (citing Examining State Business Incorporation Practices: A Discussion of S. 569: the Incorporation Transparency and Law Enforcement Assistance Act: Hearing on S. 569 Before the S. Comm. on Homeland Sec. & Governmental Affairs, 111th Cong. 8 (2009)).

²⁴⁹ *Id.* at 875-876.

²⁵⁰ *Id.* at 876.

protect shareholder value and prevent unlawful activity or hostile takeovers²⁵¹ while allowing public transparency in ownership that is necessary to manage company performance. Such an ownership disclosure regime can only benefit the company's performance and increase the legitimacy of transparent company ownership disclosure regimes while also boosting investor confidence.

CONCLUSION

The purpose of this article is to contribute to the growing debate on mandating company ownership disclosure, its impact on capital markets, and contributions or constraints on corporate performance.

Recent international and comparative studies as well as market analyses indicate that, while much has been accomplished by way of legislating mandatory disclosure of beneficial ownership information within national borders, the deafening pace of innovation in financial instruments as well as the creative use of corporate vehicles across international jurisdictions have made existing accomplishments moot in terms of fighting cross-border illicit activities and financial crimes.

This article argues that, on balance, mandatory ownership disclosure and enforcement regimes have a more positive contribution to company performance than any constraints they may impose. At the same time, to achieve the much-desired goal of a publicly transparent beneficial ownership regime, greater focus and effort is needed in the areas of harmonized definitions of beneficial ownership and transparency, harmonized, integrated and consistent cross-border ownership disclosure thresholds, notification frameworks that leverage technology and reduce procedural pitfalls and inefficiencies, reduced or subsidized compliance cost management frameworks, especially for small business owners, and increased political will across all major developed and developing economies towards combatting the illicit use of corporate vehicles for unlawful gain. In a global economy, the real competition is not between well-meaning domestic companies or cross-border, multinational enterprises. The real competition is between all of these legitimate, innovative corporations and those who seek to use such vehicles for terrorism financing, money laundering, tax evasion, cross-border

²⁵¹ See generally Kalant, *supra* note 3, at 1059-66 (discussing, in particular, the potential positive impact of U.S.'s ITLEAA bill on combatting illicit activity, exposing the use of shell corporations for illegal purposes and improving law enforcement's ability to expose and prosecute financial crimes such as money laundering that affect taxpayers and the government).

arms sales, and manipulation of shareholder voting rights and capital markets.

The battle has just begun.