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Beneficial Ownership and Control: A Comparative Study - Disclosure, Information and Enforcement

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Abstract

BENEFICIAL OWNERSHIP AND CONTROL: A COMPARATIVE STUDY DISCLOSURE, INFORMATION AND ENFORCEMENT

By Erik P.M. Vermeulen*

Investor confidence in financial markets depends in large part on the existence of an accurate disclosure regime that provides transparency in the beneficial ownership and control structures of publicly listed companies. This is particularly true for corporate governance systems that are characterised by concentrated ownership. On the one hand, large investors with significant voting and cash-flow rights may encourage long-term growth and firm performance. On the other hand, however, controlling beneficial owners with large voting blocks may have incentives to divert corporate assets and opportunities for personal gain at the expense of minority investors.

The paper focuses particularly on the misuse of corporate vehicles, which arguably poses a major challenge to good corporate governance. Stakeholder rights (e.g. employees and creditors) cannot be properly exercised if ultimate decision-makers in a company's affairs cannot be identified. The accountability of the board may also be seriously endangered if stakeholders and the general public are unaware of decision-making and ultimate control structures. Finally, regulators and supervisory agencies have a strong interest in knowing beneficial owners – in order to determine the origin of investment flows, to prevent money laundering and tax evasion and to settle issues of corporate accountability.

JEL Classification: G30, G32, K22, K42
Keywords: beneficial ownership, control-enhancing mechanisms, corporate governance, disclosure, inside blockholders, money laundering, outside blockholders, private enforcement, public enforcement, shareholders.

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EXECUTIVE SUMMARY

Investor confidence in financial markets depends in large part on the existence of an accurate disclosure regime that provides transparency in the beneficial ownership and control structures of publicly listed companies. This is particularly true for corporate governance systems that are characterised by concentrated ownership. On the one hand, large investors with significant voting and cash-flow rights may encourage long-term growth and firm performance. On the other hand, however, controlling beneficial owners with large voting blocks may have incentives to divert corporate assets and opportunities for personal gain at the expense of minority investors.

This paper does not only concern the protection of minority investors. It also takes the interests of other stakeholders and society as a whole into account. The paper focuses particularly on the misuse of corporate vehicles, which arguably poses a major challenge to good corporate governance. Stakeholder rights (e.g. employees and creditors) cannot be properly exercised if ultimate decision-makers in a company's affairs cannot be identified. The accountability of the board may also be seriously endangered if stakeholders and the general public are unaware of decision-making and ultimate control structures. Finally, regulators and supervisory agencies have a strong interest in knowing beneficial owners – in order to determine the origin of investment flows, to prevent money laundering and tax evasion and to settle issues of corporate accountability.

A good corporate governance infrastructure should combine transparency, accountability and integrity and this requires knowledge of beneficial ownership. The protection of minority investors and other stakeholder protection will be challenging without access to reliable information about the ownership, including the identity of the controlling owners, and control structures of listed companies. In this respect, this paper makes three major claims about the nature and scope of the disclosure and reporting regime.

The first claim is that it is crucial for the functioning and development of financial markets that there is a strong regime of proportionate measures to identify beneficial ownership through disclosure and investigation mechanisms. The second claim in this paper is that, in order to provide minority investors with adequate information about the ownership structure of a publicly listed company, it is key that control-enhancing mechanisms, which give controlling investors voting/control rights in excess of their cash-flow rights, are disclosed on a regular basis. The final claim is that the disclosure regime should be supplemented with a mix of public and private investigation and enforcement mechanisms, which encourage beneficial owners to effectively make disclosures and inform the company, other investors and the market about the control structure and their intentions. In the spirit of finding the right mix, governments should introduce and develop non-judicial, informal enforcement mechanisms, such as "information requests" and private and public reprimands.

The disclosure and enforcement regime should be designed to give governments and regulators the opportunity to respond quickly to alternative investment techniques, such as cash-settled equity derivatives. On the other hand, legitimate majority shareholding should not be deterred from taking an active role in monitoring management in listed companies. For the functioning of financial markets that have become increasingly internationally-oriented and complex, it is essential that legal rules and requirements that enable information sharing on an international level be available and effectively implemented by national supervisory authorities.

I. INTRODUCTION

This paper has been requested by Bapepam-LK, the Capital Market and Financial Institution Supervisory Agency in Indonesia, in the context of the OECD-Indonesia policy dialogue on disclosure of beneficial ownership and control, launched in Bali on 5 October 2011.[1] The objective is to support policy makers and regulators in their efforts to enhance disclosure and enforcement of beneficial ownership and control as part of overall efforts to improve corporate governance standards and practices in Indonesia. The expected impact is: facilitate a comparative analysis of how disclosure of beneficial ownership is handled by other jurisdictions; highlight the costs, benefits and practicality of various approaches.

Corporate governance is important for the efficient functioning of markets and enterprises. An effective and sustainable corporate governance infrastructure helps promote investor confidence and assists firms in meeting investors' expectations. It also helps regulators to deal effectively with systemic issues and stakeholders to play their roles within the company. It is based on accountability and integrity of corporate boards. The financial crisis has dramatically highlighted these issues and policy makers and stakeholders once more bemoaned the absence of a corporate governance infrastructure that adequately protects shareholders and other stakeholders in listed companies.[2] There is often a lack of clear solutions for (potential) conflicts in listed companies caused by concentrated ownership and control. Concentrated ownership or blockholder structures have always been the predominant corporate structure and are not illegitimate if proper governance rules are in place. This means that corporate control structures have to operate within a framework of transparency. It is widely acknowledged that disguised control structures and misuse of corporate vehicles cannot be tolerated.

The accumulation of control in one or more shareholders may very well benefit minority investors by making management more accountable, thereby reducing managerial self-dealing problems.[3] However, controlling shareholders also have incentives to exploit corporate opportunities and engage in abusive related party transactions. The question thus arises whether a country's corporate governance infrastructure is sufficient to protect minority investors and other stakeholders against opportunistic behaviour of controlling beneficial owners.

[1] This programme is being organised in partnership with the Government of Japan.

[2] See OECD, "Corporate Governance and the Financial Crisis: Key Findings and Main Messages", June 2009.

[3] See A. Shleifer and R.W. Vishny, *A Survey of Corporate Governance*, 52 The Journal of Finance 737 (1997).

This paper:

- Critically assesses the legal and regulatory regimes and practices governing the disclosure and reporting of ownership and control structures in listed companies in various countries and regions around the world. We focus on the European Union, and the implementation of its rules in France and Italy, the United States and Asia (Indonesia, China and Malaysia). We attempt to assess to what extent and through which channels relevant ownership and control information is reported and provided to the company and its investors, the market and regulators and supervisory authorities.

- Reviews the strategies that are employed to enforce the legal regimes and practices. We observe several instruments through which public agents and private economic actors may initiate investigation and enforcement measures to ensure that listed companies and their investors abide by the existing disclosure and reporting rules and regulations. It leads to the question of which instruments are most appropriate and least disruptive to an effective functioning of the financial market.

- Considers a number of policy recommendations and evaluates the impact they may have on a country's corporate governance infrastructure and, more importantly, on a country's business community. The information about the legal regimes and practices, including their enforcement, is largely based on a questionnaire survey.[4]

1.1 Challenges for policy makers and regulators

1.1.1 Inside and outside ownership: costs and benefits

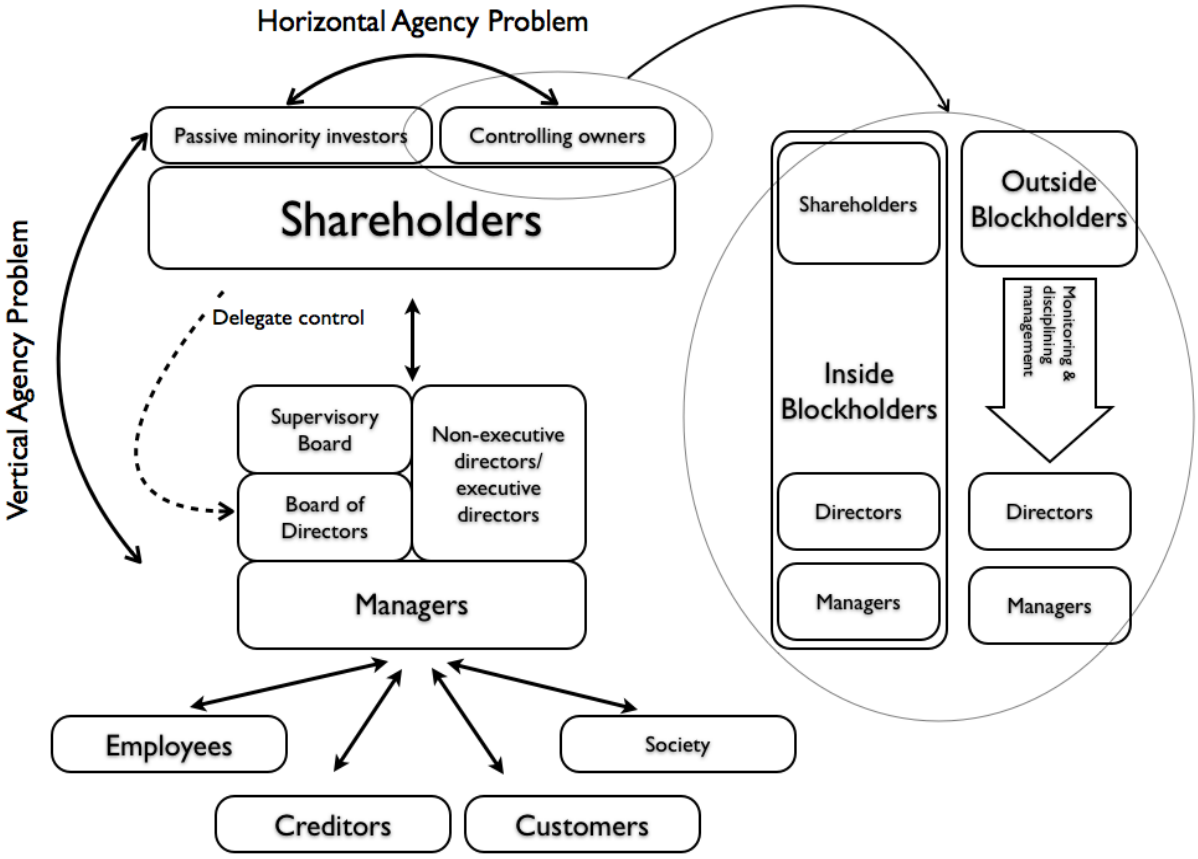
Policy makers and regulators are again concerned with designing a corporate governance framework that is better able to protect investors from misbehaviour and self-interested managers and controlling shareholders. The debate focuses on the principal-agent relationship between those with actual control over the company and minority investors, stakeholders, such as employees, customers and suppliers, and society in general.

In so-called market systems, which are characterised by widely dispersed, small and numerous shareholdings, liquid trading markets, the emphasis of the discussion is mainly on creating mechanisms that are intended to curtail agency problems between self-interested management and passive investors.[5] These problems can largely be explained by the "vertical agency relationship" in which the managers are the agents and the shareholders are the principals (see Figure 1). The agency problems in market systems stem from shareholders being passive and not at all engaged in monitoring and, if necessary, disciplining management. In economic jargon, the "separation of ownership and control" provides management with the opportunity to use superior information about a company's strategies, policies and prospects opportunistically and self-interestedly, without the risk of being detected.

[4] The questionnaire is attached to this report as a separate Annex.

[5] See W.W. Bratton and J.A. McCahery, *Incomplete Contracts Theories of the Firm and Comparative Corporate Governance*, 2 Theoretical Inquiries in Law 745, 2001.

Figure 1. Agency problems in blockholder systems



In concentrated ownership or blockholder systems, found in many variations in Europe, Asia and most other capitalist economies, the magnitude of the "vertical agency problem" is mitigated because some investors tend to have larger stakes in listed companies and hence have more incentives to monitor and discipline management. Here, one should distinguish between two types of listed firms in blockholder systems.

Firstly, there are listed companies, such as most institutional investor "controlled" companies, in which the substantial voting rights and cash-flow rights are identical and based on the proportion of total shares held. These investors, generally referred to as "outside blockholders", make listed companies prone to a three-way conflict between controlling shareholders, managers and minority shareholders. Since outside blockholders usually mitigate the problems related to managerial opportunism, it is not surprising that policy makers and regulators focus on possible conflicts that may occur in the "horizontal agency relationship" between outside blockholders and passive minority investors.[6] To see this, note that in the current financial world, which is typically characterised by high frequency trading and rapid and continuous changes in share ownership, institutional investors are inclined to focus on short-term

[6] See L.A. Bebchuk and R.J. Jackson Jr., *The Law and Economics of Blockholder Disclosure*, The Harvard John M. Olin Discussion Paper Series, Discussion Paper No. 702, July 2011.

returns.[7] The short-term stance of outside blockholders' investment strategy makes minority shareholders vulnerable to opportunistic behaviour.[8]

For example, recent research shows that before the financial crisis was imminent, powerful institutional investors encouraged managers of their portfolio companies to pursue more risky and opportunistic growth strategies in order to spur short-term shareholder returns.[9] The fact that outside blockholders, owing to more advanced trading practices and technologies, increasingly use derivative instruments and short-selling techniques in order to make profits, just adds to the "horizontal agency problem" between outside blockholders and minority investors.[10]

Secondly, there are listed companies, such as many family-owned – and sometimes even state-owned – companies, with inside blockholders, who actually hold management positions or serve on the board of directors of the companies in which they invest (see Figure 1).[11] "Vertical agency problems" are irrelevant, but "horizontal agency problems" abound in listed companies with inside blockholders. The controlling shareholders may employ several strategies to extract resources and assets from firms they control, thereby significantly increasing the horizontal agency costs. These include: (1) dilutive share issues, (2) insider trading, (3) withholding important information, (4) allocation of corporate opportunities and business activities and (5) related party transactions.

A simple example illustrates the possible expropriation of minority shareholders by controlling shareholders who engage in related party transactions either directly or through one or more of their subsidiaries. Imagine that a shareholder owns 51% of the voting shares in company A and that this shareholder also owns 100% of the outstanding shares of company B. If company A is a supplier of company B, the controlling shareholder may be tempted to reduce the transfer price of products sold and delivered to company B. This way profits are maximised in company B, which the shareholder controls and, more importantly, owns all the cash-flow rights of, while profits are minimised in company A at the expense of the minority shareholders. As the example shows, the key concern about related party transactions is that they may not be undertaken at market prices, calling for strict disclosure and reporting regimes that provide minority investors with information about the blockholder's controlling identity, interest and intentions.[12]

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[7] See C. Van der Elst and E.P.M. Vermeulen, Europe's Corporate Governance Green Paper: *Do Institutional Investors Matter*?, Lex Research Topics in Corporate Law & Economics 2011-2 Working Paper (available at http://ssrn.com/abstract=1860144).

[8] The legal framework of a listed company provides parties with a differentiated management and control structure in which shareholders elect directors and participate in certain fundamental decisions, and directors establish policies, select managers, perform monitoring functions, and act as the company's agents. Because the controlling shareholder elects the directors, they are usually able to practically control the management and supervision of a listed company.

[9] See D.H. Erkens, M. Hung and P.P. Matos, *Corporate Governance in the 2007-2008 Financial Crisis: Evidence from Financial Institutions Worldwide*, ECGI – Finance Working Paper No. 249/2009.

[10] When institutional investors sell short, they sell borrowed shares under the expectation that they will be able to buy the shares back in the market at a lower price.

[11] See C.G. Holderness, *A Survey of Blockholders and Corporate Control*, FRBNY Economic Policy Review, April 2003.

[12] It should be noted that related party transactions play an important and legitimate role in a market economy. For firms, trade and foreign investments are often facilitated by inter-company

1.1.2 The importance of "strict" disclosure and reporting mechanisms

There is a wide array of legal mechanisms designed to prevent or restrict corporate actions that may lead to opportunistic behaviour by blockholders. For instance, pre-emption rights in company law statutes give all shareholders in a company the right to be offered any newly issued shares before the shares are offered to either non-shareholders or one or more of the existing shareholders. Because the offer of new shares to existing shareholders must usually be made on a *pro-rata* basis, this legal provision prevents blockholders from expropriating the interests of minority investors by initiating dilutive share issues.

Another example of legal provisions that regulate potentially self-dealing transactions can be found in the listing rules of several Asian countries. The listing rules of the Hong Kong and Singapore stock exchanges, for instance, insist that material related party transactions are put to a vote by the minority shareholders of listed companies, providing them with information and control over expropriation attempts.

No matter how effective these mechanisms are, they are not by themselves a sufficient remedy for the legal and regulatory challenges raised by concentrated ownership and blockholders. Indeed, minority investors must have the means of monitoring and observing blockholders' behaviour in order to detect possible opportunism and expropriation at an early stage. Therefore, the existence of an accurate disclosure and reporting regime that provides transparency in the ownership and control structures of publicly listed companies is considered as the linchpin of an effective corporate governance infrastructure. This conclusion is not new to policy makers and regulators.[13] Most jurisdictions passed legislation mandating shareholders to disclose and report the accumulation of a substantial ownership of shares. The reporting requirement includes the ownership of bearer shares, which is often still considered legal and appropriate. Bearer shares are normally not registered in a shareholders' register, making it almost impossible to quickly determine the identity of the shareholders. To be sure, registration with the company is often necessary if holders of bearer shares intend to vote or want to receive dividends. Without effective disclosure and reporting requirements, however, bearer shares would enable shareholders to secretly acquire potential control over a listed company, thereby facilitating market manipulation and abusive tactics.

The rationale behind the disclosure requirements is to alert minority investors to material changes in corporate control and ownership structures and to enable them to make an informed assessment of the effect of these changes. Still, there is more to be done. The effect of disclosure and reporting requirements depends largely on the scope and definitions of ownership and control. Even if the use of bearer shares is abolished or restricted, there are a number of other legitimate ways of concealing the true identity of the ultimate beneficial owner of a company's shares. The picture of ownership and control will thus still be blurred if there is no disclosure or reporting requirement for the "ultimate" beneficial owners to reveal their identity. For instance, if disclosure must only be made at the level of direct shareholders, the use of nominee

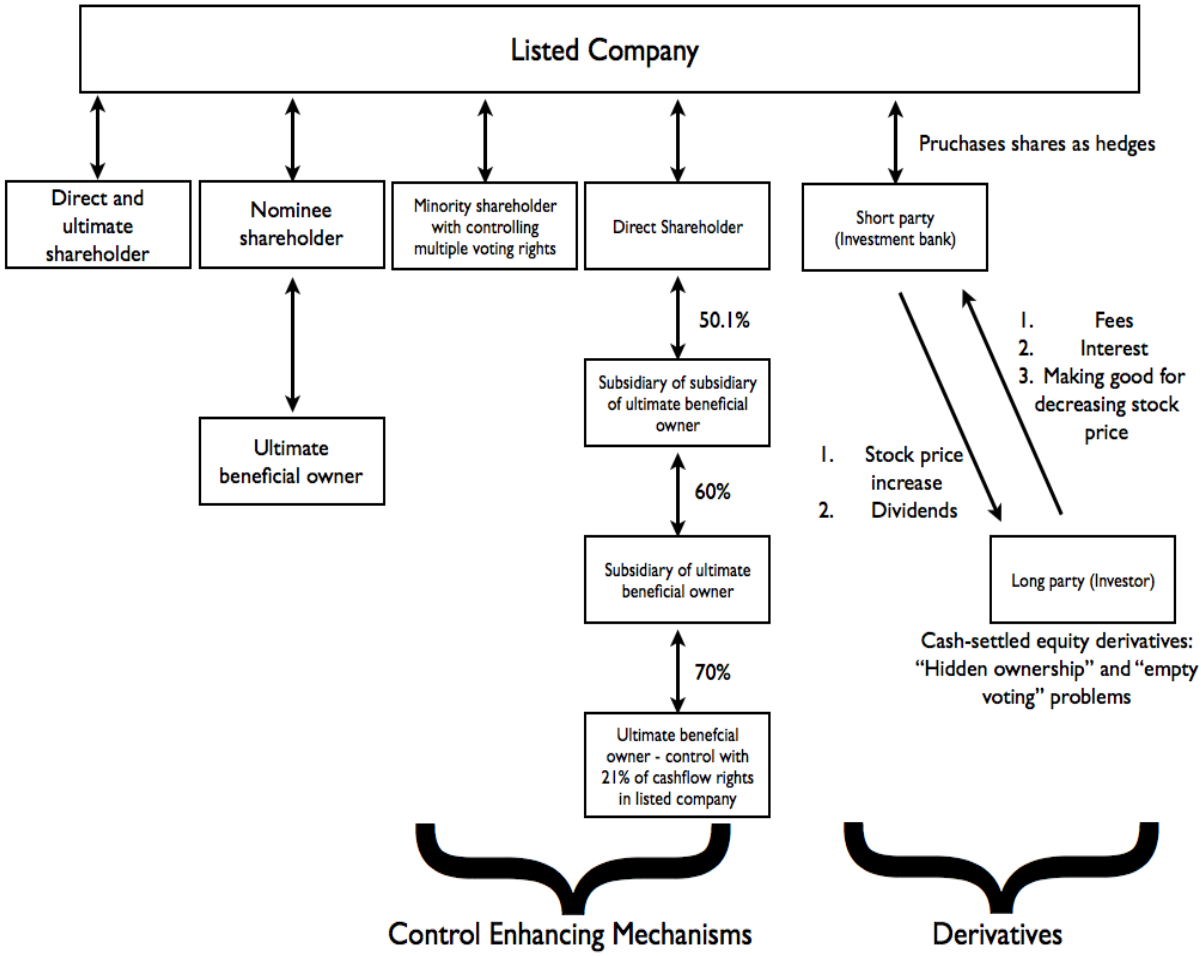
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financing transactions. Lower costs of capital and tax savings provide a strong incentive for engaging in related party transactions. Indeed, there are many examples of related party transactions that yield benefits for companies. The most popular transactions include (1) inter-company loans or guarantees from parent to foreign subsidiary, (2) a leasing or service agreement between a parent and a foreign subsidiary, and (3) the sale of receivables to a special purpose entity.

[13] See F.H. Easterbrook and D.R. Fischel, "The Economic Structure of Corporate Law", Harvard University Press, 1991.

shareholders, other intermediaries, chains of corporate vehicles or equity derivatives will mask the identity of investors (see Figure 2).

Figure 2. The need to disclose the ultimate beneficial owner



Source: Adapted from D. Zetzsche, *Continental vs. Schaeffler, Hidden Ownership and European Law – A Matter of Law or Enforcement*? Heinrich-Heine-University Düsseldorf, Faculty of Law, Center for Business and Corporate Law Research Paper Series (CBC-RPS).

1.1.2.1 Nominee and omnibus accounts

In practice, a nominee shareholder is typically a company created for the purpose of holding shares and other securities on behalf of investors. They hold the shares on trust for one or more beneficial owners, and often only they are identified on the register of shareholders. Usually, foreign investors have to open single-client nominee accounts because their global account provider is not permitted to participate directly in a local Central Securities Depository (CSD). The concern for regulators is clear: the appointment of nominee shareholders would, in effect, provide beneficial owners with the opportunity to shield their identity from investors and other stakeholders, making it more difficult to detect expropriation by controlling beneficial owners.

Likewise, policy makers and regulators increasingly express concerns about omnibus accounts. An omnibus account is a securities account that involves many investors. Although the account is opened in the name of the account provider, it should be viewed as an umbrella covering a large number of individual accounts. Omnibus accounts seriously reduce transaction

costs that are due to clearing and settlement fees and procedures. However, because the breakdown behind the omnibus accounts is often hidden for the listed companies and their investors, they could also be viewed as just another attractive instrument to conceal the identity of beneficial owners.

1.1.2.2 Derivatives

Recently, cash-settled equity derivatives and related techniques were used to obtain effective control of the underlying shares without the need for disclosure under the transparency and disclosure regimes. To see this, consider the following transaction. An investor (also called holder of the long position) purchases and acquires from a derivatives dealer or bank (the holder of the short position) a long cash-settled swap covering the underlying shares in a listed company. Under the agreement between the holder of the long position and the holder of the short position, the investor benefits from price increases in the underlying shares and incurs losses if the price decreases. The derivatives dealer usually assumes a neutral risk position by physically acquiring the underlying shares at the strike price of the derivative. The swap arrangement thus results in a decoupling of the voting rights from the beneficial ownership of the shares. The decoupling leads to "hidden ownership" and could also result in "empty voting" issues.[14] Hidden ownership refers to the situation where a cash-settled equity derivative gives the investor a long position in the shares of a listed company that remains undisclosed until the investor physically acquires the shares or the settlement arrangement is formally changed from a cash settlement to a physical settlement. Empty voting occurs when the derivatives broker votes the shares as directed by the investor.

1.1.2.3 Control-enhancing mechanisms

Investors often employ complex control and ownership arrangements designed to give them voting/control rights in excess of their cash-flow rights. These arrangements are commonly employed by inside blockholders who usually have voting control, even if they ostensibly have no majority stake in the company. Voting rights, for instance, can be separated from cash-flow rights by setting up pyramid or cross-shareholding structures, issuing multiple voting rights shares, and participating in shareholder coalitions. Ownership pyramids or cascades are the most widely used mechanism to accumulate control power with a relatively limited investment in most countries in the world. For instance, Table 1 shows that pyramid structures prevail in Europe. They enable a shareholder to maintain control through multiple layers of ownership while, at the same time, sharing the investment with other (minority) shareholders at each intermediate ownership tier. Pyramid structures reduce the liquidity constraints of large shareholders while it allows those shareholders to retain substantial voting power.

[14] See H.T.C. Hu and B. Black, *Empty Voting and Hidden (Morphable) Ownership: Taxonomy, Implications, and Reforms*, 61 Business Lawyer 1011, 2006; E.S. De Nardis and M. Tonello, *Know Your Shareholder: The Use of Cash-Settled Equity Derivatives to Hide Corporate Ownership Interests*, Conference Board Director Notes No. DN-009, July 2010.

Table 1. Control-enhancing Mechanisms in Europe

Control-enhancing Mechanisms	Availability	Actual Use
Pyramid structure	100%	75%
Shareholders agreement	100%	69%
Cross-shareholdings	100%	31%
Supermajority provisions	87%	N/A
Multiple voting rights shares	50%	44%

Source: Report on the Proportionality Principle in the European Union, External Study Commissioned by the European Commission.

In a similar vein, the issuance of multiple voting rights shares provides shareholders with control in excess of their share ownership. The separation of beneficial ownership from control rights (or voting rights) results in significant private benefits beyond the usual financial return on the shares. The negative effect of concentrated ownership is reflected in the size of the control premium. This is the difference between the market value of shares, and how much someone is willing to pay for those shares if they confer (or maintain) control over a company.

The existence of a control premium reflects the gains that majority shareholders can make at the expense of minority shareholders. The size of the control premium depends on a number of factors, including the competition in the market for corporate control, the size of the block sold, the distribution of shares in the target firm, the inequality of voting power, the nationality of the buyer, and the financial condition of the firm involved. The existence of large private benefits of control suggests that blockholders may be able to obtain a large share of the rents. For instance, the holder of multiple voting rights shares is usually allowed a seat on the board of directors and will thus receive non-public information on the company's cost structure and performance.

Control-enhancing mechanisms are prone to severe agency problems. Recent empirical research shows that the use of pyramid structures has a negative impact on firm value.[15] This could be explained by decreasing incentives of controlling investors to monitor management in the event they "only" have a minority of the economic interest in a company. The research supports calls for improvements in the corporate governance infrastructure of most countries. What type of legal rules and other regulatory strategies will best serve the infrastructure's goal of limiting the effects of self-interested transactions involving controlling shareholders? In response to the weaknesses of a corporate governance infrastructure, policy makers could address the agency problems by either banning control-enhancing mechanisms or by providing increased transparency and disclosure. The first option, however, may have some detrimental effects on the innovative and entrepreneurial potential of fast-growing listed companies (see Box 1), making disclosure and reporting requirements for control-enhancing mechanisms the preferred option.

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

Box 1. The Google case

Google, Inc., a Delaware corporation, decided to extend the "Google way" of doing business to its corporate governance structure. At some point in time, the Google founders and its Chief Executive Officer owned approximately 90% of the outstanding class B shares, giving them 68% of the firm's total voting rights while their economic interest was only approximately 20% (making them inside blockholders). The multiple voting rights shares did not seem to withhold investors from buying class A Google shares. In fact, these investors could actually consider Google's multiple voting rights share structure as good practice during the growth and development stage of the listed company, because it gives controlling shareholders (the founders) an incentive to monitor the firm closely and exposes the founders personally to the firm's public shareholders and other stakeholders. The fact that Google ranked high on the Financial Times Global 500 largest companies in 2010 seems to indicate that the control-enhancing mechanisms do not necessarily have a detrimental effect on firm value.

1.1.2.4 Chains of corporate vehicles

Chains of corporate vehicles could also be used by controlling beneficial owners to conceal their true identity and set up complex ownership structures and arrangements in listed companies. Box 2 gives a recent example. Companies may have legitimate or clear economic motives to use chains of corporate vehicles. However, the use of a chain of local and offshore corporate vehicles or international holding structures is sometimes an indication that controlling beneficial owners engage in abusive and opportunistic behaviour.

Box 2. Variable Interest Entities in China

The "variable interest entity" (VIE) structure is a chain of corporate vehicles and contractual arrangements, designed to comply with China's restrictive foreign direct investments (FDI) measures that protect many domestic industries and service sectors. As a first step, an offshore legal entity will be established. The offshore entity owns and controls one onshore wholly foreign-owned enterprise (WFOE) or foreign-invested enterprise (FIE). The onshore company gains control over a domestic company that operates in one of the restricted sectors by entering into several service agreements. These agreements allow foreign investors to hold controlling stakes in Chinese companies. This VIE structure, which is common in internet and e-commerce sectors, makes it possible for Chinese companies to access foreign capital markets through offshore listings. Sina.com was the first internet company that pursued a listing on NASDAQ through a VIE structure. According to statistics of the US Securities and Exchange Commission (SEC) and the Hong Kong Exchange (HKEx), 34 Chinese VIEs gained access to stock exchanges in the United States in 2010. In the same year, 4 VIEs were "listed" on the Hong Kong Stock Exchange. Despite being used for the IPOs of many Chinese businesses, the VIE structure poses risks to investors arising out of its complex structure. Consider the Alibaba-Yahoo dispute. Yahoo owns 43% of Alibaba, a Chinese internet group, through a VIE structure. Despite its "controlling" stake, Yahoo could not prevent Alibaba from spinning off its online payments division, Alipay, as a domestic company controlled by Alibaba's chairman, Jack Ma. The restructuring was justified as necessary in order for Alipay to obtain the necessary payment business permit from the People's Bank of China. Allegedly, the bank would have refused to issue the permit to Alibaba, if it had foreign ownership through a VIE structure.

Whilst misuse of corporate entities is often difficult to discover, it is acknowledged that (potential) misuse of corporate vehicles can be limited by the maintenance and sharing of information on beneficial ownership and control in the corporate vehicle through a number of legal and regulatory measures. These measures include: (1) an up-front beneficial ownership disclosure to the public authorities and official intermediaries, (2) mandating private corporate service providers to maintain beneficial ownership information, and (3) primary reliance on an investigative system. In the second part of this paper, we discuss the mechanisms for hiding the identity of the beneficial owners of corporate vehicles in more detail. More importantly, we critically assess the ability of anti-money laundering and anti-terrorism rules to provide transparency in the area of ownership and control in listed companies, thereby protecting minority investors in general.

1.1.3 Beneficial ownership and control: the challenges

The difficulties involved in tracing ultimate beneficial ownership and, more importantly control, make it onerous for minority investors and other stakeholders to discover and curtail self-dealing, such as asset stripping, related party transactions and share dilutions by the ultimate controlling beneficial owners. Not surprisingly, the recent financial crisis calls for stricter disclosure and reporting rules that help uncover the complicated control structures used by ultimate beneficial owners of listed companies.

On 7 March, 2011, for instance, the Securities and Exchange Commission (SEC) of the United States received a petition for rulemaking submitted by a law firm recommending amendments to the regulatory provisions that govern disclosures required by persons who "beneficially own" more than 5% of a class of equity securities of a publicly listed company.[16] The petition specifically requested that the time period within which beneficial ownership reports must be filed with the SEC be shortened pursuant to the SEC's statutory authority provided in Section 13(d) of the Securities Exchange Act of 1934. The petition also asked the SEC to broaden the definition of beneficial ownership to include ownership interests held by persons who use derivative instruments. The proposed amendment would ensure that investors have information about all persons who have the potential to change or influence control of the issuer.

There is something to be said for the call for stricter disclosure and reporting rules and regulations. Investors fare better in a corporate governance environment that allows beneficial owners to acquire control either directly or indirectly through derivatives or chains of corporate vehicles (if this meets a company's specific governance needs and requirements) than in a system that prohibits beneficial market activity.[17] In order to protect minority investors, policy makers and legislatures should therefore consider the introduction of clear and stringent disclosure and transparency obligations that offer minority investors a true picture of ownership and control structures and, more importantly, reveal the identity of the persons who should be considered as the ultimate beneficial owner.

Indeed, a good corporate governance infrastructure should ideally combine large investor involvement with legal protection of minority investors. Obviously, minority investor protection will be challenging without access to reliable information about the ownership, including the identity of the controlling owners, and control structures of listed companies. However, despite clear benefits, a disclosure and reporting regime has its costs as well.

A recent analysis by Lucian A. Bebchuk and Robert J. Jackson Jr. cast doubt on whether the rules in the United States should be tightened.[18] Firstly, they argue that empirical research has shown that controlling beneficial owners provide benefits to other shareholders "by making incumbent directors and managers more accountable, thereby reducing agency costs and managerial slack".

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[16] See Wachtell, Lipton, Rosen & Katz, Letter to the Securities and Exchange Commission – Petition for Rulemaking Under Section 13 of the Securities Exchange Act of 1934, 7 March 2011.

[17] See also M. Kettunen and W-G Ringe, *Disclosure Regulation of Cash-Settled Equity derivatives – An Intentions-Based Approach*, University of Oxford, Legal Research Paper Series, July 2011 (available at http://ssrn.com/abstract=1844886).

[18] See L.A. Bebchuk and R.J. Jackson Jr., *The Law and Economics of Blockholder Disclosure*, The Harvard John M. Olin Discussion Paper Series, Discussion Paper No. 702, July 2011.

Secondly, they show that tighter rules could seriously decrease blockholders' incentives to engage in monitoring. For instance, outside blockholders' monitoring and disciplining activities can be explained by a listed company's stock price not reflecting the company's potential. A (too) strict and disproportional disclosure and reporting regime that obliges a blockholder to disclose its position at a very early stage without being able to benefit more from relatively low stock prices, would arguably discourage them from engaging in monitoring, thereby increasing "vertical agency costs". Indeed, public information about the presence of outside blockholders will have a price increasing effect on a listed company's stock price and, as a consequence, reduce the incidence and size of outside blocks.

Thirdly, they point to the lack of empirical evidence that the current trading technologies and practices, such as cash settled derivatives, have led to increased accumulations of ownership.

Fourthly, they argue that strict disclosure regimes tilt the playing field against blockholders' monitoring activities. A disclosure and reporting regime could target several types of beneficial owners: (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. Clearly, the market is particularly interested in the third category of beneficial owners. Targeting the whole range of beneficial owners could further discourage legitimate blockholders' activities.

Finally, they point out that tightening the disclosure regime cannot be justified on the grounds that it is needed to protect minority investors. A stringent disclosure and reporting regime could lead to information overload. Stricter disclosure and reporting requirements that increase the complexity and quantity of information in the financial market, make it more difficult for minority investors to make informed and considered choices regarding their investments. This is especially true if rules and regulations endeavour to target ownership through complex derivatives arrangements even if the "owner" does not seek control.[19]

Subsequent to the petition for more stringent rulemaking, another law firm acting on behalf of institutional investors submitted a paper to the SEC which, in line with the views of Bebchuk and Jackson, opposed the change on the grounds that shortening the time period would be bad for all investors.[20] The SEC has not proposed any rule changes so far, and it is currently not clear if and whether the SEC will do so. As we will see, the SEC also declined to adopt any changes to the relevant rules so as to require cash-settled equity derivatives to be treated as conferring beneficial ownership in the summer of 2011.

It follows from the above discussion that the design of a balanced and effective disclosure and reporting regime into a country's corporate governance framework poses something of a challenge. Who – and at which shareholder level – should report a stake in a listed company? When should the disclosure be made and to whom? What should be disclosed? Through which channels should beneficial ownership and control be reported? Who will have access to the reported information?

Arguably, countries need a proportionate and flexible reporting and disclosure regime to combine the best of two "worlds": protection against self-dealing activities without creating disincentives for (outside) blockholders to intervene in badly managed companies (see Table 2).

[19] See M.K. Brunnermeier and M. Oehmke, *Complexity in Financial Markets*, Working Paper, 2009.

[20] See Wilmer Cutler Pickering Hale and Dorr LLP, Letter to the Securities and Exchange Commission – Consideration of Section 13(d) Rules, File No. 4-624, 5 August 2011.

Furthermore, in order to have practical relevance, the disclosure and reporting requirements should be complemented with investigation and enforcement mechanisms. Without these mechanisms, the disclosed and reported information is most likely inaccurate.

Table 2. Beneficial Ownership and Control: The Challenges for Policy Makers and Regulators

Outside blockholders	Inside blockholders
The Good: Outside blockholders have an incentive to improve management by making incumbent directors and managers more accountable and thereby reducing agency costs and managerial slack.	**The Good:** Inside blockholders tend to overcome underinvestment problems. Moreover, fast-growing and innovative listed companies tend to benefit from the presence of inside blockholders.
The Bad: Outside blockholders could decide to pursue short-term opportunistic activities.	**The Bad:** Inside blockholders have a strong incentive to reap private benefits of control through self-dealing and insider trading.
The disclosure regime should not be too stringent. Outside blockholders invest in monitoring in their belief that the actual (low) share price does not reflect the true value of the company. Empirical research shows that their monitoring activities protect minority investors against managerial slack. The share price will increase dramatically when the presence of outside blockholders is disclosed. This has a negative effect on the incentives of the blockholders to buy additional shares to increase their stake, preventing them from becoming a stronger blockholder and reducing their expected returns.	**The disclosure regime** should be stringent and demanding. Inside blockholders have an incentive to protect their private benefits of control at the expense of minority investors.

Source: Adapted from L.A. Bebchuk and R.J. Jackson Jr., *The Law and Economics of Blockholder Disclosure*, The Harvard John M. Olin Discussion Paper Series, Discussion Paper No. 702, July 2011; X. Chen and J. Yur-Austin, *Re-measuring agency costs: The effectiveness of blockholders*, 47 The Quarterly Review of Economics and Finance 588, 2007; A. Ferrell, *The Case for Mandatory Disclosure in Securities Regulation Around the World*, Harvard Law School John M. Olin Center for Law, Economics and Business Discussion Paper Series, Paper 492, 2004.

For instance, in Germany, the shareholders of a private company (*Gesellschaft mit beschränkter Haftung*) must be registered in a public shareholders' register. Until recently, there were no incentives for the companies and its shareholders to update the registers. The practical relevance of these registers was therefore limited owing to the lack of investigation and enforcement mechanisms. It should be noted, however, that the presence of *de jure* enforcement mechanisms does not guarantee compliance with a disclosure and reporting system. Empirical research in the area of disclosure and filing of annual accounts in non-listed companies in Europe indicates that even if there is a *de jure* enforcement of the obligation to file an annual account, the *de facto* lack of enforcement actually discourages companies to abide by even the most stringent rules.[21]

In this light, this paper provides a balance sheet for disclosure and reporting regimes in countries around the world. The first item of the balance sheet, to which we now turn, is the reporting requirement for beneficial owners that hold a significant stake in a listed company.

[21] See J.A. McCahery and E.P.M. Vermeulen, "Corporate Governance of Non-Listed Companies", Oxford University Press, 2008.

II. DISCLOSURE OF CONTROL STRUCTURES AND THE IDENTITY OF BENEFICIAL OWNERS

As noted in the previous Section, disclosure and reporting rules and regulations are important elements of the corporate governance infrastructure in a country. Adequate disclosure and reporting requirements are widely recognised as crucial to mitigate the adverse effects of self-dealing and opportunistic behaviour by controlling shareholders and ensure the accurate pricing of securities. Moreover, information about a company's controlling shareholding structure and voting rights is crucial for regulating the conflicts between controlling and minority investors.

For instance, the European Union, characterised by control and insider coalitions, has long recognised the importance of mandatory disclosure of significant shareholdings. In 1988, the EU adopted a Directive on the Information to be published when a Major Holding in a Listed Company is Acquired or Disposed of.[22] This Directive was later repealed by the Transparency Directive,[23] which provides an improved framework for periodic and *ad hoc* disclosure. One of the aims of the Transparency Directive is to harmonise the disclosure regime regarding significant shareholdings so as to enhance investor protection across the European Union. The Directive intends to complement the corporate governance infrastructure of the Member States by introducing rules that are designed to set the minimum standard for supplying investors with timely information about acquisitions or disposals of voting rights of listed companies exceeding or falling below certain thresholds.

Firstly, Article 9 provides that investors will be required to disclose the acquisition or disposal of shareholdings in listed companies whose securities are admitted to trading on a regulated market, based on thresholds starting at 5% continuing at intervals of 5% until 30% of the voting rights.[24] This rule aligns the disclosure practices amongst the Member States whilst allowing certain local governments to broaden the scope of the transparency rules and/or require disclosure at an earlier stage or at closer intervals. The French legislature, for instance, extended the disclosure requirement to economic actors who entered into agreements or acquired other financial instruments that give them the right to acquire a substantial number of shares at their sole discretion in the near or intermediate future.

Secondly, the Directive, through Article 12(2), requires a notification of a change in a major shareholding to four trading days (starting one day after the shareholding exceeds or falls below one of the thresholds mentioned in Article 9). Subsequently the listed company should inform the public of the change in major shareholding within three trading days after receipt of the notification. In France, Article 223-17 of the AMF General Regulation adds that the notification should also include an investor's intentions if the thresholds of 10%, 15%, 20% or 25% are exceeded.

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[22] See Directive 88/627/EEC.

[23] See Directive 2004/109/EC. The Transparency Directive was due to be implemented on 20 January 2007.

[24] The thresholds are 5%, 10%, 15%, 20%, 25%, 30%, 50% and 75%.

Thirdly, the notification requirement applies to various classes of shares, such as warrants and convertible bonds if the holdings reach or fall below certain thresholds (Article 16). The rationale behind the inclusion of certain types of derivatives is based on the view that influence over a company may also be directed through such financial contracts. Finally, the Directive does not apply to (1) shares acquired for the sole purpose of clearing and settling within the usual short settlement cycle, or (2) shares held by custodians in their custodian capacity provided that they can only exercise the voting rights attached to such shares under instructions given in writing or electronically.

A recent study on the application of the Transparency Directive indicates that the Directive is widely considered to add to the quality of the corporate governance infrastructure of the European Member States.[25] That is to say that the Directive appears to achieve its objectives of providing accurate, comprehensive and timely information to the market. However, the recent market turmoil and illiquidity have raised questions about the scope of the transparency and disclosure requirements under the Directive.

A recent Commission report on the operation of the Transparency Directive,[26] for instance, stated that the Transparency Directive should be adapted to innovative and complex investment instruments in financial markets. Improved disclosure of stock lending practices as well as cash-settled equity derivatives should avoid problems of "empty voting" and "hidden ownership".[27] An example of an "improved" disclosure regime can be found in France. Article 223-11 of the Autorité des marchés financiers (AMF) General Regulation provides that the holders of financial instruments related to shares to be issued or with similar economic effect to holding shares (i.e. cash-settled equity swaps) must also be disclosed when one of the thresholds is reached.[28] On 25 October 2011 the European Commission presented a proposal to amend the Transparency Directive. The proposal seeks to address the "hidden ownership" and "empty voting" issues by extending the disclosure requirements to cash-settled equity derivatives.[29] The European Securities and Markets Authority (ESMA) has been entrusted with ensuring a consistent and proportionate application of the Directive by drafting regulatory technical standards.

And there is more to be done, according to corporate governance experts.[30] In the aftermath of the financial crisis, there has been a dramatic increase in attention to promoting shareholder

[25] See Commission Staff Working Document, *The review of the operation of Directive 2004/109/EC: emerging issues*, SEC(2009) 611, 27 May 2010.

[26] See European Commission COM (2010)342 final, 27 May 2010.

[27] See Section 1.1.2.2 of this paper. See also European Commission, Commission Staff Working Paper, Impact Assessment SEC(2011) 1279 final, 25 October 2011.

[28] In France, the thresholds are 5%, 10%, 15%, 20%, 25%, 30%, 33.33%, 50%, 66%, 90% and 95%.

[29] See European Commission, Proposal for a Directive of the European Parliament and of the Council amending 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 and Commission Directive 2007/12/EC, COM (2011) 683 final, 25 October 2011.

[30] See European Central Bank and Target 2 Securities, T2S Taskforce on Shareholder Transparency – Final Report to the T2S Advisory Group, Version: 28 February 2011. See also Le club des juristes (Commission Europe), *Recommendations and Best Practice for Issuers and Institutional Investors*, April 2010.

engagement in corporate governance matters.[31] By rethinking the engagement with their portfolio companies, institutional investors could usher in a new ownership and control culture that would benefit minority investors and other stakeholders alike. It is suggested that new corporate governance measures should be introduced to spur institutional investors' involvement in monitoring and assessing the long-term strategy of listed companies. This is necessary in market systems, which are characterised by high frequency trading and rapid and continuous changes in share ownership.

Regulators seem to take the stand that the growing importance of stock prices when assessing the performance of companies seems to encourage only short-term thinking. Long-term shareholders' engagement is important to counterbalance this trend. In this respect, institutional investors could provide markets and other shareholders with substantial benefits. Since these investors tend to conduct extensive research before taking significant trading positions, they could contribute to market efficiency. It appears, however, that it is not an easy task to engage institutional investors in the decision-making processes of listed companies.[32]

For instance, the use of nominee and omnibus accounts has a blurring effect on the true picture of ownership and control, making it difficult for management of a listed company to initiate a sustainable dialogue with investors. Clearly, in Europe the current Transparency Directive with its disclosure thresholds is insufficient for identifying institutional beneficial owners.

The national corporate governance infrastructures of many Member States contain rules and requirements that enable listed companies to request for shareholders' identification in light of the participation and voting in general shareholders' meetings.[33] However, there is no EU-wide mechanism allowing listed companies to obtain information about the identity of all the beneficial investors. Therefore, to improve the corporate governance infrastructure, proposals have been made to revise the Transparency Directive. The main idea behind the revision is to include an EU-wide shareholder identification mechanism to allow listed companies to receive information about first, second and subsequent layer shareholdings, irrespective of shares being held as bearer shares or through nominee and omnibus accounts. Figure 3 provides a high-level overview of how shares can be held and, more importantly, how information can be obtained. Explanations of some of the most commonly used terms in describing shareholding and ownership structures are provided in Box 3.

[31] See C. Van der Elst and E.P.M. Vermeulen, *Europe's Corporate Governance Green Paper: Do Institutional Investors Matter*?", Lex Research Topics in Corporate Law & Economics 2011-2 Working Paper (available at http://ssrn.com/abstract=1860144).

[32] See OECD, "Corporate Governance and the Financial Crisis: Key Findings and Main Messages", June 2009.

[33] The Shareholders' Rights Directive of 11 July 2007 (Directive 2007/36/EC) states that Member States may allow companies to ensure the identification of shareholders before enabling them to exercise their voting rights and rights to information.

Box 3. Explanation of terms used to describe shareholding structures

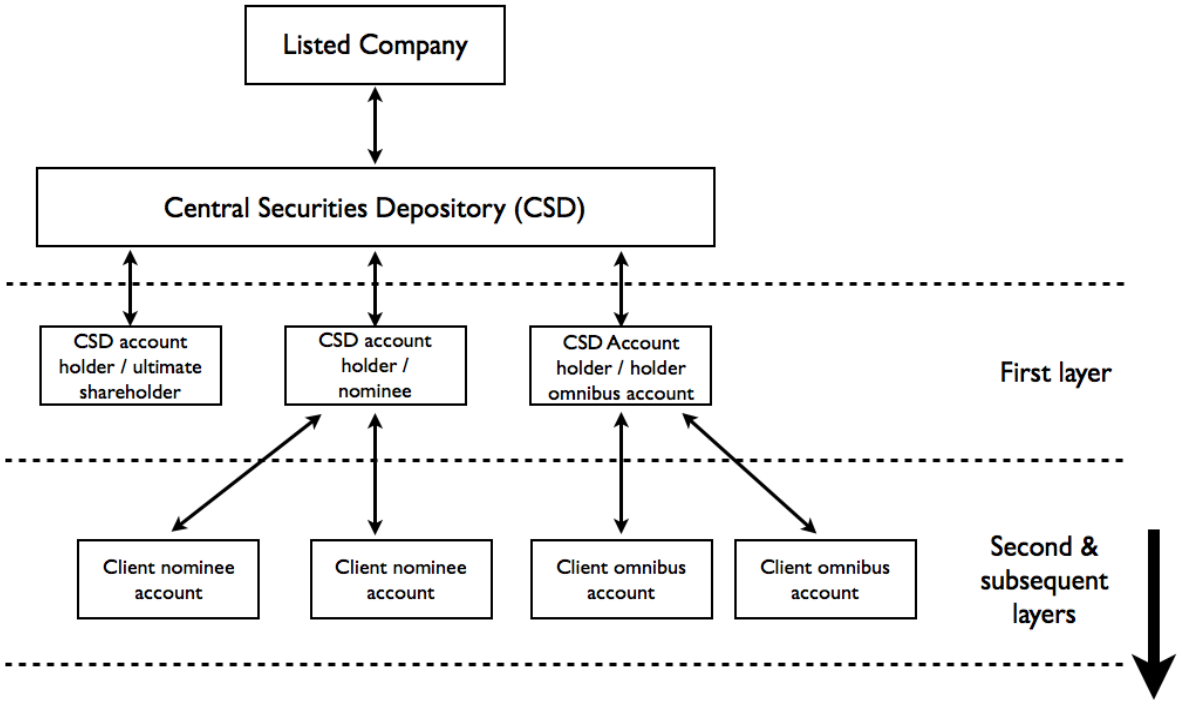
First layer "shareholders": The information available at the level of the account holder at Central Securities Depository (CSD). The account holder may be, but is usually not, the ultimate beneficial owner of the shares. If an intermediary with an account at the CSD holds its securities in separate sub-accounts according to each client, then these sub-account holders are also defined as the "first layer". In some jurisdictions these account holders are considered as the shareholders who are entitled to vote. This is, for instance, the case in Austria, Estonia, Spain, Ireland, Slovenia and the United Kingdom.

Second and subsequent layer "shareholders": Intermediaries holding shares as nominees or acting as omnibus account holders.

Final layer "shareholders": The end-investor or beneficial owner. In the majority of European Member States, the final layer is recognised as the shareholder. This is the case in Belgium, Bulgaria, Cyprus, Germany, Finland, France, Greece, Italy, Lithuania, Latvia, the Netherlands, Poland, Portugal, Romania and Sweden.

Source: Adapted from (1) European Central Bank and Target 2 Securities, T2S Taskforce on Shareholder Transparency – Final Report to the T2S Advisory Group, 28 February 2011, (2) European Central Bank and Target 2 Securities, *Market Analysis of Shareholder Transparency Regimes in Europe*, 9 December 2010, and (3) Rejaul Karim Byron and Gazi Towhid Ahmed, Omnibus account used as umbrella: Stock crash probe finds top share culprits hid their identities, trail of foul play, The Daily Star, 11 April 2011.

Figure 3. Multiple layers of shareholdings



It depends on the corporate governance infrastructure of a country whether information about the beneficial owners is easily accessible or not. For instance, in Europe, most Member States have information going as far as the final layer for domestic participants. However, if shares are held through a foreign intermediary, only first layer information is usually available.

Sourc
e: Adapted from European Central Bank and Target 2 Securities, T2S Taskforce on Shareholder Transparency – Final Report to the T2S Advisory Group, Version: 28 February 2011; European Central Bank and Target 2 Securities, *Market Analysis of Shareholder Transparency Regimes in Europe*, 9 December 2010.

In the next section, we compare the European transparency and disclosure regime with the rules and regulations in the United States and Asia and highlight the differences. We start with the implementation of the EU directive in Italy, contrasting it with the experiences in Asia, in which a high proportion of listed companies have significant concentrations of voting blocks, and the United States, which is characterised by a market system with widely dispersed shareholders.

2.1 Comparative overview

2.1.1 Italy

The Italian Consolidated Law on Finance and CONSOB (Commissione Nazionale per le Società e la Borsa, the Italian securities regulator/supervisory authority) Issuers' regulation contains provisions that require the disclosure of physical shareholdings if certain thresholds are met. The first threshold, which deviates from the Transparency Directive, is set at 2%. The subsequent thresholds are 5%, 10%, 15%, 20%, 25%, 30%, 35%, 40%, 45%, 50%, 66.6%, 75%, 90% and 95%. Long and short positions acquired through derivative instruments also have to be disclosed when the following thresholds are met: 2%, 5%, 10%, 15%, 20%, 25%, 30%, 50% and 75%.

Despite Italy's 2% threshold, it is fair to say that the regulatory 5% threshold to disclose beneficial ownership is the international norm. Countries that implemented a stricter threshold, like Italy and, as we will see, Malaysia, have taken or are taking measures to amend the rules. In Italy, for instance, there is evidence that institutional investors keep their participations just below the 2% threshold. They are reluctant to disclose their positions, which will undoubtedly lead to an increase in compliance costs. It should therefore come as no surprise that CONSOB, the Italian securities regulator, decided to raise the threshold for certain investors, such as mutual funds in 2009. Still, this measure is probably not enough. The pressure to relax the rules for all investors is slowly but surely increasing in Italy.

The challenge of devising an effective disclosure regime is apparent in Italy. On the one hand, we see a trend to introduce more flexible and proportionate disclosure rules and requirements. On the other hand, however, CONSOB looks for ways of introducing a more stringent disclosure regime. For instance, in May 2011, CONSOB issued a consultation document on extending the disclosure obligations to positions held through cash-settled equity derivatives. Notification of major shareholdings must be made by the ultimate controlling person for the total number of shares held (through subsidiaries, controlled undertaking, trusts, and nominees). The information that should be made available is indicated on a standard form. This form must be filed by the shareholder to CONSOB and the respective listed company within five trading days from the moment that the ownership threshold has been reached. CONSOB will then, after having verified the accuracy of the information, disclose the shareholding to the market through its website within three trading days.

CONSOB's website (www.consob.it) is publicly accessible and contains a wealth of up-to-date information about a company's ownership and control structure. It provides both Italian and foreign investors and other interested parties with detailed ownership and control information about significant shareholders (persons holding, directly or indirectly, together or alone, more than 2% of the share capital). The website has very user-friendly features, such as the possibility of visualising the control and ownership structures of listed companies in a pie chart. Information about "significant" changes in the shareholding structure is separately accessible. The same is true for changes in "potential" holdings through derivative arrangements.

2.1.2 The United States

In the United States, the Securities and Exchange Act of 1934 (Exchange Act) principally governs the disclosure and reporting of ownership and control structures in listed companies. Sections 13(d) and 13(g) of the Exchange Act require a person who is the beneficial owner of more than 5% of certain equity securities to disclose information relating to such beneficial ownership within 10 calendar days after the Section 13(d) threshold is crossed. These statutory sections do not provide a definition of the term "beneficial owner". However, the Commission has adopted flexible rules that determine the circumstances under which a person is or may be viewed as such. Consider here Exchange Act Rule 13d-3, which provides objective standards for determining when a person is or may be deemed to be a beneficial owner subject to Section 13(d). Application of Rule 13d-3 allows for case-by-case determinations as to whether a person is or becomes a beneficial owner itself.[34]

The SEC does not make case-by-case determinations about beneficial ownership by particular investors. Instead, investors and their advisors must apply the SEC's rules to determine when and how to report beneficial ownership; the general principles set forth in the rules allow some flexibility for a standard "market practice" application of the rules to develop over time in response to particular sets of facts. Occasionally, the staff of the SEC may, if requested by an investor, provide unofficial guidance to the investor regarding a particular set of facts in the form of what is called a "no-action" letter (the terminology refers to the confirmation in the letter that the staff will not recommend enforcement action by the SEC against a party on the basis of a particular set of facts). The SEC staff more frequently publishes general guidance to investors in the form of "compliance and disclosure interpretations" that set forth the staff's view as to how rules should be interpreted or applied to particular situations. The staff of the SEC also reviews market developments from time to time to determine if changes to the rules or the published interpretations are necessary.

Generally, beneficial owners are defined under Rule 13d-3(a) as persons who may, directly or indirectly, vote or dispose or direct the voting or disposition of a voting class of equity securities registered under Section 12 of the Exchange Act. The beneficial ownership reporting requirements provide investors and the respective listed company with information about accumulations of voting classes of equity securities that may have the potential to change or influence control over the listed company. The statutory and regulatory framework establishes a reporting system for collecting and disseminating information about the ownership of publicly held equity securities. As mentioned, this framework is established under Sections 13(d) and 13(g) of the Exchange Act.

Under Section 13(d) and Schedule 13D, a beneficial owner who is required to report must disclose the background and identity, residence and citizenship of, and the nature of the beneficial ownership by, such person and all other persons by whom or on whose behalf the purchases have been or are to be effected. The disclosure must also cover the number of shares beneficially owned, the source of funds used to purchase the shares, and if the purpose of the purchase is to acquire control of the listed company, then any plans of the reporting person to liquidate the company, to sell its assets, to engage it in a merger, or other specified transactions.

Section 13(d)(2) of the Exchange Act and corresponding Rule 13d-2(a) require that material changes to the information disclosed in Schedule 13D be disclosed in an amended filing. The

[34] See Securities and Exchange Commission, "Beneficial Ownership Reporting Requirements and Security-based Swaps", (SEC Release No. 34-64628, June 8, 2011).

acquisition or disposition of beneficial ownership of securities in an amount equal to 1% or more of a class of securities is deemed material under Rule 13d-2(a), although acquisitions or dispositions of less than those amounts may be material, depending on the facts and circumstances. Other material changes in the facts disclosed must likewise be disclosed. An amendment to a Schedule 13D must be filed promptly at EDGAR, the SEC's Electronic Data Gathering, Analysis, and Retrieval system. EDGAR performs automated collection, validation, indexing, acceptance, and forwarding of submissions by companies and others who are required by law to file forms with the SEC. EDGAR aims to increase the efficiency and fairness of the financial market by accelerating the receipt, acceptance, dissemination, and analysis of time-sensitive beneficial ownership and control information filed with the SEC. In addition, the SEC's website contains information on SEC enforcement proceedings including descriptions of, among other things: civil suits filed in federal court, administrative proceedings filed before the SEC, and trading suspensions.

The financial crisis has raised questions, similar to what we have seen in Europe, as to whether the disclosure regime under Section 13(d) should be tightened. For example, Section 766 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 amended the Exchange Act by adding Section 13(o), which provides that "a person shall be deemed to acquire beneficial ownership of an equity security based on the purchase or sale of a security-based swap" if the Commission adopts rules after making certain determinations with respect to cash-settled equity derivatives and consulting with the prudential regulators and the Secretary of the Treasury. However, on 8 June, 2011, the SEC readopted, in accordance with Section 13(o), the relevant portions of the existing Exchange Act Rules 13d-3 and 16a-1 without change, effectively declining to alter the treatment of cash-settled equity derivatives for purposes of determining "beneficial ownership" of equity securities under Sections 13 and 16 of the Exchange Act.

2.1.3 China

Rules and regulations regarding the disclosure and reporting of beneficial ownership and control structures can be found in the Companies Law of the People's Republic of China, the Law of the People's Republic of China on Securities (China Securities Law), the Administrative Measures for the Disclosure of Information of Listed Companies, and, dependent on where the company is listed, the Rules Governing the Listing of Stocks on Shanghai Stock Exchange or the Rules Governing the Listing of Stocks on Shenzhen Stock Exchange.

China's Securities Law and regulations state that any listed company must disclose the information about the beneficial ownership and voting rights of its major shareholders in the annual reports and semi-annual reports. This information includes: (1) the total number of shareholders by the end of the reporting period, (2) the names of shareholders holding 5% or more of the company's outstanding shares, as well as changes in shareholdings. It should be noted that the regulations also provide that anyone who is not a physical shareholder but is able to hold actual control over the acts of a company by means of investment relations, agreements or any other method should be considered to be "in control" and, hence, should comply with the disclosure rules.

In addition, Article 3 of the Administrative Measures on Information Disclosure by Listed Companies stipulates that the directors of listed companies shall ensure the accuracy and completeness of the information disclosed. Article 24 states, moreover, that the directors of a company shall sign and endorse regular reports. If directors are unable to verify the information, they should include the conclusions of their findings in the report.

Finally, it is stipulated in Article 90 of the Code of Corporate Governance of Listed Companies that the secretary of the board of directors may at the company's discretion supplement the legal rules and regulations regarding the information that has to be disclosed. For instance, the company can issue internal rules regarding consultation procedures so as to ascertain that the disclosed information is correct. According to Articles 87-89, the company is responsible for ensuring a proper disclosure. The beneficial ownership and control information should be reported to the respective stock exchange as well as the China Securities Regulatory Commission (CSRC).

2.1.4 Indonesia

Investors in Indonesia have to abide by several legislative and regulatory provisions designed to ensure the disclosure and reporting of direct shareholdings. Rule No. X.K.6 and Rule No. X.M.1 issued by Bapepam-LK are examples of such provisions. According to Bapepam-LK Rule No. X.K.6 regarding the obligation to submit an annual report, listed companies are required to annually disclose and report information regarding significant direct shareholders who own 5% or more of the company's shares.

This information becomes also available on the website of the Indonesia Stock Exchange (www.idx.co.id). Bapepam-LK Rule No. X.M.1 requires all significant direct shareholders who own 5% or more of the outstanding shares to send a report containing information about the shareholding to the Indonesian Capital Market Supervisory Agency (Bapepam-LK) within ten days from the transaction date. A copy of the report must be made available to the Indonesia Stock Exchange and to the Clearing Guarantee Institution. The report must at least include the following information: (1) the name, address and nationality of the shareholder, (2) the number of shares purchased or sold, (3) the purchase and the selling price, (4) the date of the transaction, and (5) the purpose of the transaction.

As for the first layer of "shareholdings", Bapepam-LK Rule No. X.C.1 obliges the Central Securities Depository (PT Kustodian Sentral Efek Indonesia – KSEI) to inform Bapepam-LK as soon as a registered "shareholder" acquires 5% or more of the shares. The information includes, among other things, (1) the name of the stock account holder, (2) the name of the client (the holder of stock sub-account), (3) the address (if any) and citizenship (or statutory address for corporate vehicles), (4) the name of the listed company; and (5) the date of the transaction.

2.1.5 Malaysia

The primary requirements regarding the disclosure and reporting of beneficial ownership and control can be found in (1) the Malaysian Companies Act 1965 (Malaysian Companies Act), (2) the Capital Markets & Services Act 2007 (CMSA), the Securities Industry (Central Depositories) Act 1991 (SICDA), the Listing Requirements of Bursa Malaysia Securities Berhad (Listing Requirements), and the Rules of Bursa Malaysia Depository Sdn Bhd (Depository Rules). The details of how these requirements work is described below.

2.1.5.1 Company law

Section 158 of the Malaysian Companies Act (last amended in 2006) provides that companies must maintain a register of its members. The register is not publicly available, but open for inspection by any member free of charge [Section 160(2)]. The register contains the following information [Section 158(1)]: names, addresses, identity card numbers, nationality, any other relevant information about the members, the number of shares held by each member and

the amount paid or agreed to be considered as paid on the shares of each member; the date at which the person became a member or ceased to be a member; and the date of every allotment of shares to members and the number of shares comprised in each allotment. A member may request the company to provide him with a copy of the register, but only so far as it relates to names, addresses, number of shares held and amounts paid up, upon payment of RM1.00 for every 100 words [Section 158(3)].

In addition to the shareholders' register, a separate register of the substantial shareholders must be maintained (Section 69L), containing the following information: (1) names, nationality, addresses and full particulars of the voting shares in the company in which the substantial shareholder has an interest or interests, full particulars of such interest and the reasons for the shareholder's participation [Section 69E(1)]; or (2) where there is a change in the interest or interests, full particulars of the change including the date of the change and the circumstances by reason of which the change occurred [Section 69F(1)]; or (3) where a person ceases to be a substantial shareholder, his name, and the date on which he ceased to be a substantial shareholder and a detailed explanation of the reasons for the shareholder ceasing to be a substantial shareholder [Section 69G(1)].

The shareholder who owns a substantial stake in a company has a duty to ensure that a notice is sent to this company regarding the substantial interest in the company within seven days after becoming a substantial shareholder (Section 69E); any change in the substantial interest (Section 69F) including if he/she ceases to be a substantial shareholder (Section 69G). A substantial shareholder is a person (including natural persons, whether citizens or non-citizens, and corporate vehicles, whether carrying on business in Malaysia or not – Section 69C) who owns 5% or more of the voting shares of the company (Section 69D). Interest here has been broadly defined to include deemed interest arising from, for example, a contract to purchase shares, a right to acquire a share or an interest in a share under an option (Section 6A).

Section 69O also provides that any listed company may require any of its members: (1) to inform it whether the member holds any voting shares in the company as beneficial owner or trustee; and (2) if the member holds as trustee, to indicate so far as possible the identity of the persons for whom he holds the shares; and (3) to require any member to inform the company whether any of the voting rights are the subject of any agreement or arrangement under which another person is entitled to control the exercise of these rights. The listed company may also require any other person who has an interest in the voting shares in the company to provide similar information. Furthermore, the Companies Act empowers the Registrar of Companies at the Companies Commission to request a company, person or individual to furnish information regarding the particulars of any share acquired or held directly or indirectly either for his own benefit or for any other company, person or individual and have them verified by a statutory declaration (Section 69A). The requested information can be filed electronically. It is also possible to upload documents.

2.1.5.2 Listing requirements

Besides the detailed company law rules, there are more disclosure requirements in Malaysia. For instance, the Listing Requirements contain the following key rules on disclosure of ownership and control: a listed company must immediately announce any received notice relating to substantial shareholding [paragraph 9.19(17) and (18)], and any change of control in the listed issuer [paragraph 9.19(41)].

Moreover, a listed company must include a statement setting out the following information in its annual report (paragraph 23, Appendix 9C): names of significant shareholders (excluding bare trustees) and their direct and deemed interests stating the number and percentage of shares in which they have an interest as shown in the register of significant shareholders; direct and deemed interests of each director (including number and percentage) in the listed issuer or in a related corporation, appearing in the register of directors' shareholdings; number of holders of each class of equity securities and any convertible securities and the voting rights attached to each class; distribution schedule of each class of equity securities and any convertible securities setting out the number of holders and their percentage stake in the company; names of the 30 securities account holders having the largest number of securities from each class of equity securities and convertible securities according to the Record of Depositors, and the number and percentage held.

The announcements that listed companies have to make under the Listing Requirements can be submitted through the Bursa Malaysia Listing Information Network ("Bursa LINK"). Bursa LINK is an electronic platform that automates the receipt, dissemination, storage and retrieval of listed corporations' announcements, prospectuses, circulars, information memorandum, quarterly reports, annual reports etc. Bursa LINK not only provides users with easy access to upload information, it also enables regulators, investors and other market participants to instantly obtain information about beneficial ownership and control structures.

2.1.5.3 Depository rules

Finally, the Securities Industry (Central Depositories) Act 1991 (SICDA) provides that every securities account with the central depository (i.e. Bursa Malaysia Depository Sdn Bhd) should be opened in the name of the beneficial owner of the deposited securities or in the name of an authorised nominee (being a person who is authorised to act as a nominee as specified under the Depository Rules) [Section 25(4)]. The Depository Rules further provide that where the securities account is opened in the name of an authorised nominee, the authorised nominee must: (1) stipulate the name of the beneficial owner in a special application form [Rule 25.02B(2)]; and (2) furnish to the central depository the name of and other relevant information about the beneficial owner [Rule 25.02(4)]. If an authorised nominee fails to provide the information required by the Central Depository pursuant to Rule 25.04, the central depository may revoke the authorised nominee's authority to act as an authorised nominee, suspend any or all securities accounts held by the authorised nominee for such period as may be specified by the central depository or issue any instruction or directive or impose any condition on the authorised nominee as the central depository deems fit [Rules 25.02(5) and (6)].

Thus, even though custodians and nominee companies are allowed to operate omnibus accounts, they are under an obligation to disclose the beneficial owner of the securities upon request of the regulator (the Securities Commission of Malaysia). They will be subject to sanctions if they fail to comply with this duty.[35] It must be noted however that any information or document relating to the affairs of any of the depositors, and in particular, relating to their securities accounts, are prohibited from being disclosed to any person (Sections 43 and 44 of the SICDA). Section 45 provides instances where and the parties to whom such information may be disclosed, e.g. if the depositor has consented to the disclosure or if the disclosure is required in the public interest.

[35] See generally Section 5 of this paper.

2.2 Key findings and main messages

In light of the foregoing discussion, what is the balance sheet for the disclosure and reporting regimes in the respective countries (see Table 3)? Their benefits are widely acknowledged: they provide minority investors and other stakeholders with the necessary information about the beneficial owners of listed companies and the control structures that these owners employ. Without this information the minority investors and other stakeholders in a listed company are insufficiently protected against market manipulation and abusive tactics by controlling owners.

In this respect, it is not surprising that Malaysia is viewed as a regional leader in minority protection.[36] Malaysia's disclosure system is very extensive and detailed. In this respect, it could be viewed as a rules-based system that offers a high level of disclosure and reporting requirements and, equally important, easy and electronic access to ownership and control information. Minority investors and other interested parties can find information going as far as the final layer of beneficial owners provided that the beneficial owner is considered to be a substantial shareholder who holds, either directly or indirectly, at least 5% of the outstanding shares.

Similarly, the United States has clear, accessible and also flexible rules that provide transparency in the different layers of shareholdings. EDGAR and its widely reputed web-based access 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. Here, it is also worth mentioning that Italy's CONSOB not only provides a web-based portal that is accessible and easy to use, it also gives a clear presentation of the shareholding structure of listed companies.

On the cost side,[37] the discussed disclosure and reporting rules entail ostensibly no great deal of harm. But, as we have seen, overly stringent rules could discourage engagement by outside blockholders and dialogue between these blockholders and management of an underperforming listed company, thereby increasing "vertical agency costs".

Moreover, detailed and mandatory disclosure and reporting regimes that offer hardly any flexibility could have counterproductive effects. To see this, consider the following arguments. Strict disclosure regimes often have a disproportionate impact on the financial markets in that they lead to excessive compliance costs for the listed companies, their investors and the supervisory authorities. Moreover, they usually exacerbate the information overload that already exists in the financial markets.[38]

These costs formed the main reason for the reform of the beneficial ownership rules and regulations in Malaysia in 2005. Before the 1997 Asian financial crisis, Malaysia had very basic rules on beneficial ownership. The government reacted to the crisis by introducing detailed, but inflexible rules to restore investors' confidence in the financial market. However, the costs resulting from the inflexibility of the disclosure system negatively affected Malaysia's reputation

[36] See WorldBank IFC, "Doing Business 2011, Making a Difference for Entrepreneurs", (www.doingbusiness.org).

[37] See L. Enriques, M. Gargantini and V. Novembre, *Mandatory and Contract-based Shareholding Disclosure*, Uniform Law Review 15, 2010. See also Section 1.1.3 of this paper.

[38] See B. Bloch, "Information Overload: How It Hurts Investors", 28 April 2011 (www.investopedia.com).

and attractiveness, particularly to foreign investors. This eventually led to the government's decision to relax and streamline the regime in 2005.[39]

It follows from the comparative overview above that most jurisdictions currently have well-balanced regimes. For instance, flexibility and proportionality prevail in the US system. The system allows for a determination of a beneficial owner, depending on all relevant facts and circumstances. In the current era of information-based technology, the most obvious challenge is to design a legal framework that is adaptable to technological change and its impact on financial instruments. Arguably, the US approach has the benefit of making the disclosure and reporting regime adaptive to the technological evolution in financial market instruments. Additionally, the US disclosure system is adaptable to different types of beneficial owners that invest with different intentions. At one end of the spectrum, Section 13(d) of the Exchange Act requires beneficial owners who seek control to disclose their ultimate intentions in detail. At the other end of the spectrum, Section 13(g) of the Exchange Act enables certain "passive investors" without any intention of controlling the company (including qualified institutional investors that have no control purpose) to file a short-form document.

Insiders, such as directors and officers, who own certain equity securities must file a statement that contains the number of equity securities of which the insider is the beneficial owner under Section 16 of the Exchange Act. If we compare Section 13 to Section 16, it becomes evident that the US system clearly distinguishes between outside blockholders and inside blockholders. Consider in this respect the following provision in Section 16: "(f)or the purpose of preventing the unfair use of information which may have been obtained by (an insider) by reason of his relationship to the (listed company), any profit realised by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer" within any period of less than six months inures to and is recoverable by the company. Clearly, the distinction between inside blockholders and outside blockholders is relevant if one believes that the latter's engagement in a listed company significantly reduces "vertical agency costs" by closely monitoring management.

The underlying issues caused by stringent and inflexible transparency regimes can also be avoided by providing optional investigative mechanisms that listed companies and public agencies can opt into at their own discretion. Examples can be found in China and Malaysia. Malaysian listed companies, for instance, may request their shareholders to unveil detailed beneficial ownership information beyond the legal and regulatory requirements. Likewise, the Registrar of Companies at the Companies Commission may submit a similar request. Another example of an optional investigative system can be found in the Capital Markets & Services Act 2007 (CMSA). Section 317(1) imposes on directors of listed companies a duty to inform the company about any of its shares they own. The Securities Commission may request this information if it deems necessary. This seems particularly the case if the director is considered to be an internal blockholder (holding a significant number of shares in the listed company).

[39] See Nik Ramlah Mahmood, *Monitoring Beneficial Ownership, Challenges and the Way Forward for Indonesia*, presented at the OECD-Indonesia Policy Dialogue: Disclosure of Beneficial Ownership and Control, Bali, 5 October 2011.

Table 3. A balance sheet for disclosure and reporting regimes

Benefits	Costs
High level of disclosure and reporting requirements Ultimate controlling beneficial owners If ownership is control-related, intentions should be reported and disclosed Control-enhancing mechanisms (*see next Section*) **Easy and online accessibility to up-to-date and "real time" information** Examples: EDGAR, Bursa LINK, CONSOB **Flexible rules adaptable to technological change and innovative financial instruments** Exchange Act United States (case-by-case) Capital Markets & Services Act 2007 Malaysia (opt-in rules)	**Strict and stringent rules and regulations** Discourages outside blockholders' engagement Compliance and administrative costs **Information overload** The focus must be on control "Immaterial" information must not be disclosed

The investigative mechanisms ensure that Malaysia's disclosure and reporting regime is applied proportionately and only if and when necessary to help avoid information overload. Indeed, the policy makers and regulators in Malaysia appear to have implemented a well-designed disclosure and reporting regime that mainly targets beneficial owners that seek to acquire control over a listed company. Recall that a disclosure and reporting regime could target several types of beneficial owners: (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. Moreover, the information obtained from depositories by Bursa Malaysia Depository Sdn Bhd will not become publicly available.

The effectiveness of the rules and regulations, however, depends largely on the enforcement capabilities of the regulators and other public agents. Indeed, one of the concerns with the corporate governance infrastructure in Malaysia was that while there were extensive laws and other regulations that govern, among other things, disclosure and transparency issues in listed companies, there existed a significant gap between the "rules in the books" and the "rules in practice".[40]

The final part of the paper shows that Malaysia, by improving its enforcement system, has taken important steps to bridge this gap. Still, no matter how valuable the disclosed information is, the discussed disclosure regimes do not guarantee that the true picture about the control and ownership structure of a listed company is available. For instance, shareholders could have entered into arrangements that give them control in excess of ownership (without having to publicly disclose their direct position in the company). It is necessary to disclose these

[40] See The World Bank, *Report on the Observance of Standards and Codes (ROSC)*, Corporate Governance Country Assessment, Malaysia, June 2005.

arrangements as well as any other so-called control-enhancing mechanisms in order to provide an accurate picture of the control and ownership structure of listed companies. In the next section, the rules and regulations regarding control-enhancing mechanisms are discussed in more detail.

III. DISCLOSURE OF CONTROL-ENHANCING MECHANISMS AND ARRANGEMENTS

The Google case (see Box 1) showed that minority investors may have good reasons to acquire shares in a listed company that employs control-enhancing mechanisms (if these mechanisms meet the company's specific governance needs and requirements).[41] In order to protect minority investors, policy makers and legislatures should consider introducing clear disclosure and transparency obligations. In this respect, it is worth taking a closer look at the European Takeover Bids Directive,[42] which complements the Transparency Directive by requiring listed companies to provide investors with adequate information about deviations from the standard rule that voting rights (control) equal cash-flow rights (ownership). The rationale behind the Directive is twofold. Firstly, the disclosure of control and ownership information enables investors to make well-informed choices about their investments. Secondly, the reporting requirement discourages deviations from the best-practice norm in corporate governance that one share can only correspond to one vote (the "one-share-one-vote" rule).

The Directive's transparency requirement is directly relevant to the disclosure of beneficial ownership and control-enhancing mechanisms.[43] While it may true that the Directive is imperfect in that it does not directly addresses the expropriation of minority shareholders by controlling beneficial owners, the increased disclosure and transparency is arguably crucial to effectively regulate the financial market, while at the same time, discouraging market manipulation and abusive tactics.[44] Again, it should be noted here that many of the negative effects of control-enhancing mechanisms do not appear to have prevented the efficient operation of the financial

[41] See Economist, *Dual-class share structures, The cost of control*, 23 July 2011.

[42] See Directive 2004/25/EC.

[43] In particular, Article 10 mandates that companies must provide detailed information on: (1) the structure of their capital, including securities not admitted to trading on a regulated market, with an indication, where appropriate, of different classes of shares, and for each shares, the rights and obligations and the total percentage of capital it represents; (2) any restrictions on the transfer of securities; (3) significant direct and indirect shareholdings (including indirect shareholdings through pyramid structures and cross-shareholdings); (4) the holders of any securities with special control rights and a description of those rights; (5) the system of control of any employee share scheme where the control rights are not exercised directly by employees; (6) any restrictions on voting rights; (7) agreements between shareholders that are known to the company and may result in restrictions on the transfer of securities and/or voting rights; (8) the rules governing the appointment and replacement of board members and the amendment of articles of association; (9) the powers of board members, particularly in respect of the right to buy back shares; (10) significant agreements to which the company is a party and that take effect upon a change of control of the company; (11) any agreement between the company and its board member or employees providing for compensation if they resign or are made redundant without valid reason or if their employment ceases because of a successful takeover bid; and (12) this information must be published in the company's annual report.

[44] See J.A. McCahery and E.P.M. Vermeulen, *The Case Against Reform of the Takeover Bids Directive*, 22 European Business Law Review 2011.

market in Europe as well as in the United States. As we have seen, control-enhancing mechanisms can under circumstances even have a positive effect on the performance of listed companies. In order to draw informed conclusions regarding the effect of an effective disclosure regime on control-enhancing mechanisms, it is therefore important to discuss experiences in other jurisdictions.

3.1 Comparative Overview

3.1.1 Italy

Control-enhancing mechanisms, particularly shareholders agreements and pyramid structures, are common in Italy. The large established listed companies are the usual suspects. Empirical research shows that 85% of these companies employ one or more control-enhancing mechanisms.[45] As noted, these mechanisms could encourage expropriation of minority interests through corporate diversification strategies. However, the ongoing disclosure requirements, largely based on the mandatory implementation of the Transparency Directive and Takeover Bids Directive, ensure that minority investors have the necessary insights in the control structure of Italian listed companies to understand their minority position. Article 123-bis of the Italian Consolidated Law on Finance provides that control-enhancing mechanisms must be disclosed in the annual report.

3.1.2 The United States

In the United States, the "one-share-one-vote" rule is common. Shareholders holding more than 5% of any class of voting equity securities must file a Schedule 13D with the SEC. In addition to applying to individual investors, the beneficial ownership reporting provisions of Section 13 of the Exchange Act also apply to groups of investors. Sections 13(d)(3) and 13(g)(3) of the Exchange Act provide that when two or more persons act as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, holding, or disposing of securities of an issuer, such syndicate or group shall be deemed a "person". Application of these statutory provisions therefore results in an aggregation of the ownership interests of two or more persons acting in concert, and requires that a beneficial ownership report be filed by the members of the group when the amount the group members collectively beneficially own exceeds 5% of the class of equity securities. Related Exchange Act Rule 13d-5(b)(1) operates to further help determine when two or more persons should be deemed to be a "group". Rule 13d-5(b)(1) shows the disclosure's system flexibility by setting forth a test for whether two or more persons constitute a group. The test is twofold. Firstly, there must be an agreement to act together. The agreement need not be in written form. Secondly, in determining whether persons agreed to act together, the SEC and the courts look to circumstances such as contacts between persons, parallel action by persons and whether persons had similar goals. Under Rule 13d-5(b)(1), persons will be viewed as having formed a group if they agree to act together for purposes of acquiring, holding, voting or disposing of the subject equity securities.

3.1.3 China

Control-enhancing mechanisms are widely employed in family-owned listed companies and state-owned enterprises in China (see Table 4). Yet, the use of pyramid ownership structures is declining. Recent research shows that 98% of the listed companies were characterised by

[45] See Report on the Proportionality Principle in the European Union, External Study Commissioned by the European Commission.

pyramid ownership structures in 2002. In 2007, this percentage proportion decreased to 87%.[46] The downward trend is partly explained by the improved and more stringent corporate governance infrastructure in China, which currently requires the disclosure of information about the pyramidal ownership structure in their annual report.[47]

Table 4. The use of control-enhancing mechanisms (pyramids) in China in 2007

Controlling Owner	Share ownership	Voting control	Direct share ownership of second largest shareholder
Family	26%	35%	9%
Non-family	35%	39%	7%
State	36%	40%	7%

Source: R. Amit, Y. Ding, B. Villalonga, H. Zhang, *The Role of Institutional Development in the Prevalence and Value of Family Firms*, Harvard Business School Working Paper 10-103, 2010.

3.1.4 Indonesia

In Indonesia, families remain in control over "their" listed companies by setting up pyramid structures. A study conducted in 2000 reports that 67% of the listed companies have pyramid structures (see Table 5). Unfortunately, there is no recent information available. This is mainly due to the fact that listed companies are not required to disclose control-enhancing mechanisms.

3.1.5 Malaysia

Also, controlling shareholders in Malaysia tended to use pyramid and cross-holding structures to diversify their risk, while at the same time exercising control over the companies (see Table 5).[48] However, the popularity of pyramid structures has slowly but surely faded away owing to the more stringent disclosure and related party requirements.[49] For instance, in the current corporate governance infrastructure, company law and listing requirements make it mandatory for investors to disclose shareholder agreements and acting in concert strategies if they together with the other shareholders control 5% or more of the outstanding shares of the company.

[46] See S. Xiao, *How Do Agency Costs Affect Firm value? – Evidence from China*, Working Paper 2009 (on file with the authors).

[47] See M. Watanabe, *Separation of Control and Cash-Flow Rights of State-owned Listed Enterprises: Channels of Expropriation after the Discriminated Share Reform in China*, Institute of Developing Economies, Discussion Paper No. 224, 2010.

[48] See also Z. Ishak and C. Napier, *Expropriation of Minority Interests and Corporate Diversification in Malaysia*, 2 Asian Academy of Management Journal of Accounting and Finance 85, 2006.

[49] See The World Bank, *Report on the Observance of Standards and Codes (ROSC)*, Corporate Governance Country Assessment, Malaysia, June 2005.

Table 5. The use of control-enhancing mechanisms in other Asian countries

	Ratio of cash flow to voting rights	Pyramids with ultimate owners	Cross-holdings
Indonesia	0,784	67%	1%
Malaysia	0,853	39%	15%
Philippines	0,908	40%	7%
Singapore	0,794	55%	16%
Thailand	0,941	13%	1%
Japan	0,602	36%	12%
Korea	0,858	43%	9%

Source: S. Claessen, S. Djankov and L.H.P. Lang, *The Separation of Ownership and Control in East Asian Corporations*, 58, Journal of Financial Economics 81, 2000.

3.2 Key findings and main messages

We have seen that rules and regulations that require blockholders to disclose the use of control-enhancing mechanisms have a significant effect on the incidence of these mechanisms. Tightening the disclosure regime will not only lead to more transparency, but will at the same time decrease the use (and popularity) of these mechanisms. The question arises of what the balance sheet is for transparency in the area of control-enhancing mechanisms (see Table 6). The benefits are obvious. A lack of sufficient and effective reporting requirements facilitates market manipulation and abuse.

For instance, control-enhancing mechanisms, which are used to allow inside blockholders to enhance control by leveraging voting power, lead to an increased potential for fraud and tunneling. Moreover these mechanisms often function as devices for inside blockholders to capture and lock-in board and management control while being a minority investor. In fact, if the possibility of shareholders to “vote with their feet” by tendering their shares to a hostile offeror (who seeks to acquire control over the company) is severely threatened as a result of control-enhancing arrangements, market mechanisms cannot adequately align the interests of inside blockholders (and management) and other minority shareholders.

By providing a constant and credible risk of hostile acquisitions, the takeover market creates a powerful incentive for management of a listed company to restrain from managerial self-dealing. Assuming that the “market-for-corporate-control” is economically efficient in that it improves firm performance, control-enhancing mechanisms lead to an increase in both “vertical” and “horizontal agency problems”. Consequently, according to this argument, disclosure and reporting rules and regulations should at least ensure that non-controlling minority investors have adequate and up-to-date information about a listed company’s control structure.

Table 6. A balance sheet for the disclosure of control-enhancing mechanisms

Benefits	Costs
Strict disclosure rules Information about a listed company's control structure must be made available to non-controlling minority investors on a regular basis.	**Strict disclosure rules** Discourages the use of control-enhancing mechanisms. However, legitimate use by "high-tech geniuses" is accepted.

The costs of reporting control-enhancing mechanisms are harder to measure. One potential cost is that disclosure may encourage firms to abandon a governance structure even if it matches their needs in the growth and development stage. As discussed, fast-growing and high-tech companies sometimes use multiple-voting shares. The rationale is sound and simple. The possibility to issue multiple voting shares allows founders of high tech companies to raise substantial sums of capital without surrendering control. If information about control-enhancing mechanisms negatively affects a company's stock price, successful high tech companies will probably refrain from a public listing. This may not only seriously hamper the development of these companies, but also negatively influence economic growth and job creation initiatives.

Yet, even though it follows from the discussion in Section 2.1 that more stringent disclosure regimes often lead to a decrease in the use of control-enhancing mechanisms, investors in listed high-tech companies seem to be more than happy with the imbalance in the control and ownership structure of their investee company. We already discussed the Google example. Discussions about IPOs by other fast-growing companies, such as Zynga and Groupon, seem to indicate that multiple voting rights shares become more in fashion in the high tech industry. This suggests that the (potential) investors are able to distinguish companies that legitimately and proportionally implement control mechanisms from companies with disproportional or inefficient structures.[50] This observation could lead to the conclusion that strict disclosure and reporting rules for control-enhancing mechanisms are beneficial to investors and the financial market in general.

This conclusion should not be surprising to anyone who has read the paper so far: disclosure and reporting is absolutely necessary when it involves control-related information. This raises the question as to whether there are alternative sources of information available to minority investors who have an interest in pursuing an investigation in the control structures of listed companies when the discussed mechanisms fail. Consider here the rules to protect society against money laundering, terrorist financing and other illicit activities. Indeed, because controlling beneficial owners usually use national and/or offshore corporate vehicles to shield their assets from personal liability and, at the same time, hide their identity, anti-money laundering and anti-terrorism rules arguably assist minority investors in their effort to reconstruct the control structure of a listed company. The next Section analyzes whether minority investors can actually benefit from the legal framework to prevent misuse of corporate vehicles.

[50] See J.M. Mendoza, C.F. Van der Elst and Erik P.M. Vermeulen, *Entrepreneurship and Innovation, The Hidden Costs of Corporate Governance in Europe*, 7 South Carolina Journal of International Law & Business 1, 2010.

IV. DISCLOSURE OF BENEFICIAL OWNERSHIP OF CORPORATE VEHICLES

Modern corporate vehicles are diverse and serve a range of complex needs for business parties. At their core, they allow business people to carry out important commercial activities. Organising these activities through corporate vehicles solves a number of contracting problems while contributing to the development of a sophisticated and complex economic environment. The flexibility and adaptability of corporate vehicles to accommodate the financial and organisational needs of entrepreneurs and investors have arguably contributed to the deepening of financial markets. Irrespective of how effective these forms might be for meeting the needs of a broad range of businesses and investors, there have been increasing concerns about the degree to which these forms are used for tax evasion, money laundering, and other illegal or abusive transactions. The financial market and banking systems become more international and, in important respects, encourage the development of financial centers. As these centers become more established and accessible, an increasing number of individuals, businesses and opportunistic investors are likely to take advantage of the usually flexible regulation and gate-keeping systems in these centers.

For instance, offshore financial centers are not only attractive due to the flexible financial supervision, bank secrecy laws and beneficial fiscal treatment, but equally so due to their usually accessible rules regarding the formation and operation of corporate vehicles.[51] It is a common refrain that controlling beneficial owners of company shares frequently involve the use of offshore corporate vehicles or international holding structures to conceal the true identity of the shareholders. In fact, some of the major offshore jurisdictions have encouraged investors to move capital and use their financial institutions by creating legislation that effectively restrict the identity of the beneficial owners of the company. Along with the instruments for achieving anonymity, there are also a variety of legal measures, such as restrictions on gatekeepers and service providers to assist regulators with determining the true identity of parties that also allow money launders and others pursuing criminal schemes to invest with minimal scrutiny.

As we have seen, there are a number of techniques that make it difficult to establish the true ownership of a company, such as bearer shares and nominee shareholders. Modern corporate vehicles,[52] which are even less regulated than the traditional corporate form for listed companies, are even more apt for establishing chains of corporate vehicles. Lighter rules and regulation provide these entities with a more flexible structure. They can be established cheaply and often online within 24 hours. These characteristics make these types of business forms more vulnerable to misuse for illicit purposes. More importantly in the context of this paper, controlling beneficial owners of listed companies could take advantage of the light regulation of these

[51] See OECD, "Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes", 2001.

[52] See F.R. Reyes and E.P.M. Vermeulen, *Company Law. Lawyers and Innovation: Common Law versus Civil Law*, Lex Research Topics in Corporate Law & Economics 2011-3 Working Paper (available at http://ssrn.com/abstract=1907894). See also J.A. McCahery, E.P.M. Vermeulen, M. Hisatake and J. Saito, *Traditional and Innovative Approaches to Legal reform: "the New Company Law"*, 8, European Business Organization Law Review 7, 2007.

modern business forms to hide their identity and perpetrate a wide range of illegal or abusive activities. We already noted that inside blockholders often hide their identity by establishing a chain of local and offshore corporate vehicles.

This Section begins with a review of the legitimate aims of corporate vehicles and their potential for misuse by parties to engage in illicit activities. We describe and analyze the competing methods for identifying beneficial ownership and control. The primary objective of this Section is to assess whether the disclosure regime for corporate vehicles can be used as an investigative tool for minority investors and other stakeholders to obtain information about the beneficial ownership and control structures, including the identity of beneficial owners, of listed companies.

4.1 Corporate vehicles and their potential for misuse

There are many techniques available to move money swiftly and effectively to evade tax authorities and other enforcement officials. Specialists on financial crime and money laundering frequently note that perpetrators seek to avoid detection by creating a chain of company law vehicles in separate jurisdictions. Corporations, trusts, foundations, limited partnerships and now hybrid business forms, such as the limited liability partnerships (LLPs) and limited liability companies (LLCs), are the vehicles most commonly associated with misuse. These corporate vehicles are relatively simple and cost efficient to set up. For example, an offshore company acts as nominee for an offshore principal. In this construction, the nominee company represents the offshore company, and transacts all the contracts and conducts the business on its behalf, including invoicing and accounting.

The advantages are that no invoices or other papers will appear in the file of the offshore principal. Such a construction, moreover, assumes that the nominee company will not trade in its country of incorporation, buy or sell goods in its own name, and sign contracts with the nominee company outside its home jurisdiction. In order to develop the chain, parties will go on to establish companies in a third jurisdiction and so forth. Setting up a chain of corporate vehicles is usually a cost-effective solution for multinationals in their efforts to establish corporate structures that help optimise the financial results of the group of companies. However, the anonymity created by these structures serves to benefit those involved in criminal activities. In this context, jurisdictions have moved to introduce measures that make information about the beneficial owners that control these chains of companies more readily available.

The OECD (2001), which is concerned with combating corruption and money laundering, has articulated a number of policy objectives in respect of preventing the misuse of corporate vehicles. The emphasis on restricting their misuse is in line with other international initiatives that seek to establish the appropriate standards to assist authorities and financial institutions that could effectively stem cross-border crime.

As far as jurisdictions have mechanisms that make it possible to obtain access to beneficial ownership information, it is emphasised that proper oversight and high integrity of the system is necessary to ensure the adequacy and accuracy of the information. It is submitted that the misuse of legal entities can be limited by the maintenance and sharing of information on beneficial ownership and control through a number of mechanisms. These alternative mechanisms include: (1) an up-front disclosure system;[53] (2) mandating corporate service

[53] An up-front disclosure system requires the disclosure of the beneficial ownership and control of corporate entities to the authorities, chambers of commerce or any other institutions charged with responsibility at the establishment or incorporation stage and imposes an obligation to update

providers to maintain beneficial ownership information;[54] and (3) primary reliance on an investigative system.[55] Table 7 provides a "balance sheet" overview of the costs and benefits of each of these mechanisms.

Table 7. OECD options for obtaining beneficial ownership information[56]

Option	Benefits	Costs
Upfront disclosure	• improved transparency • beneficial ownership and control information available at all times • strong deterrent effect	• imposes significant costs on business vehicles (especially smaller entrepreneurial businesses)
The holding of information by intermediaries	• implementation is cheap	• costly and time-consuming for companies (particularly when foreign parties are involved) • the client identification and verification rules, and related recordkeeping requirements, represent a potentially costly and cumbersome set of identification practices. • potential for delays in the provision of information *ex post*
Investigative system	• may avoid unnecessary costs and burdens on business vehicles, which may stifle legitimate business formations • maintain a reasonable balance between ensuring proper monitoring / regulation of business vehicles and protecting legitimate privacy interests	• potential for delays in the provision of information

The OECD approach is based on the premise that the most effective technique to identify the beneficial owner is to, when necessary, pierce through the legal form of corporate vehicles in order to obtain information about the legal owner of the shares or the party that exercises

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such information on a timely basis when changes occur. The obligation to report beneficial ownership and control information to the authorities may be placed on the corporate entity, the ultimate beneficial owner, or the corporate service provider involved in the establishment or management of the corporate entity.

[54] In some jurisdictions, intermediaries involved in the establishment and management of corporate entities, such as company formation agents, trust companies, registered agents, lawyers, notaries, trustees, and companies supplying nominee shareholders, directors, and officers ("corporate service providers"), are required to obtain, verify, and retain records on the (beneficial) ownership and control of the corporate entities that they establish, administer, or for which they provide fiduciary services.

[55] Under an investigative system, the authorities seek to obtain (through compulsory powers, court-issued subpoenas, and other measures) beneficial ownership and control information when illicit activity is suspected, when such information is required by authorities to fulfill their regulatory/supervisory functions, or when such information is requested by other authorities domestically and internationally for regulatory/supervisory or law enforcement purposes.

[56] See OECD, "Options for Obtaining Beneficial Ownership and Control Information", February 2002.

effective control over the vehicle. The argument for pursuing this strategy is largely pragmatic, namely that there are an array of effective legal techniques available that permit regulators and other parties to obtain such information. The supervisory authorities, in some markets, subject financial intermediaries involved in the creation of such corporate vehicles to obtain a written declaration of the identity of the beneficial owner and renew verification of the identity of the contracting party or beneficial owner when changes occur during the operation of the business. Not only must financial intermediaries obtain the identification of the beneficial owner, but are bound to establish documents, make the information available to supervisory authorities and retain the information long after the business relationship has ended.

At a fundamental level, we see that the misuse of corporate vehicles can be controlled by a combination of mechanisms. Thus the choice between the particular mechanisms will be influenced by the efficacy of the legal system and the enforcement history and level of cross-border co-operation in the market. Differences in the legal traditions and culture will arguably complicate the exchange of information on an international level. In principle, the solution to the problem of disclosure of beneficial ownership appears to be straightforward: (1) introduce a strong national up-front disclosure system and investigative system and (2) establish international collaborations to facilitate the cross-border exchange of information among regulators. As we will see in the next subsection, the elements of a sound system of disclosure of beneficial ownership are well known by policy makers.

4.2 Combating illicit use of corporate vehicles in Europe

Over the last decade or so, the European Union has undertaken to implement uniform rules in order to curb the misuse of financial centers by criminal organisations and to contain money laundering. Money laundering is defined as the process by which a party conceals the illegal existence, illegal source or illegal application of income and then disguises it in order to make it appear legitimate. Money laundering typically involves a three-step process: placement, layering and integration. There is little disagreement about the steps needed to minimise the incidence of money laundering. However, because money laundering involves numerous forms of corruption, it is difficult to identify, let alone prosecute successfully. Given the harm that money laundering causes to financial markets and the effect that it has in undermining confidence in government and public officials, it is argued that strengthening the weak links in regulation is needed. Particularly, financial intermediaries, who usually have knowledge of the assets implicated in these transactions and a relationship with the persons that operate the corporate vehicles connected to these illicit activities, play a pivotal role.

In 2005, the European Commission embraced the Third Directive on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, which had to be implemented by 15 December 2007.[57] This Directive builds on existing EU legislation and incorporates the June 2003 revision of the Forty Recommendations of the Financial Action Task Force (FATF) (see Box 4). It repealed and replaced the 1991 Directive,[58] as amended in 2001, with the difference that it introduces additional requirements and safeguards for situations of higher risks, such as trading with banks located outside the European Union.

[57] See Directive 2005/60/EC.

[58] See Directive 91/308/EEC.

Box 4. The Financial Action Task Force

The Financial Action Task Force (FATF) is an inter-governmental body charged with promoting the development of and compliance with standards to efficiently curtail the effects of money laundering and terrorist financing. In order to meet this objective the FATF has issued Forty Recommendations, which – together with Nine Special Recommendations on Terrorist Financing – provide a complete set of principles and standards against money laundering. These international standards – collectively called the "40+9 Recommendations" – are introduced to assist countries in developing a "risk-based approach" to combat money laundering and the financing of terrorism. In addition to the 40+9 Recommendations, the FATF has promulgated a number of supplementary documents that are aimed to assist its member countries in implementing the Recommendations.

However, devising and maintaining a legal system that ensures that accurate and timely disclosure of beneficial ownership and control structures is a daunting task. Existing systems should be revisited periodically. It is therefore not surprising that FATF published its revised FATF Recommendations in February 2012. The FATF Recommendations (2012) contain, among other things, measures that are expected to significantly improve transparency regarding beneficial ownership structures. For instance, the 2012 Recommendations encourage countries to implement stricter rules and regulations that require companies or company registries to obtain and hold up-to-date information on the companies' beneficial ownership.

As for the "customer due diligence" (CDD) for legal persons and arrangements, The FATF Recommendations (2012) state that: *When performing CDD measures in relation to customers that are legal persons or legal arrangements, financial institutions should be required to identify and verify the customer, and understand the nature of its business, and its ownership and control structure. The purpose of the requirements […] regarding the identification and verification of the customer and the beneficial owner, is twofold: first, to prevent the unlawful use of legal persons and arrangements, by gaining a sufficient understanding of the customer to be able to properly assess the potential money laundering and terrorist financing risks associated with the business relationship; and, second, to take appropriate steps to mitigate the risks. As two aspects of one process, these requirements are likely to interact and complement each other naturally.*

In the context of the formation and operation of corporate vehicles, the Directive not only applies to financial services providers, such as auditors, external accountants and tax advisors, but also to legal professionals when they assist their clients in the creation, operation or management of trusts, companies or similar structures. For instance, legal professionals must engage in continuous due diligence activities throughout the course of their relationship with clients to (1) identify their clients and, more importantly, verify their identity on the basis of information obtained from a reliable source, (2) identify the beneficial owner of a client who is a legal person, trust or similar legal structure (see Box 5), (3) understand the ownership and control structure of the corporate client, and (4) report suspicious transactions to the national financial intelligence unit (FIU).

The due diligence and reporting obligations present challenges for legal professionals at two levels.[59] Firstly, the "know your client" rules and requirements represent potentially costly and cumbersome due diligence activities. Secondly, and more worrisome, tensions arise between "transparency" (i.e. the reporting obligation of legal professionals that detect or suspect illicit use of corporate vehicles) and "secrecy" (i.e., client confidentiality and lawyer-client privilege).[60] These tensions made it necessary for FATF to draft and develop principles for legal professionals that help combat money laundering and terrorist financing without undermining the lawyer-client privilege, the duty of client confidentiality or otherwise impeding the delivery of legal services

[59] See P.D. Paton, *Co-operation, Co-option or Coercion? The FATF Lawyer Guidance and Regulation of the Legal Profession*, 2010 Journal of the Professional Lawyer 165.

[60] See C. Tyre, *Anti-Money Laundering Legislation: Implementation of the FATF Forty Recommendations in the European Union*, 2010 Journal of the Professional Lawyer 69.

generally. This led to the introduction of the Financial Action Task Force RBA Guidance for Legal Professionals (Lawyer Guidance) in 2008.[61]

The 2008 Lawyer Guidance applies to legal professionals who engage in one of the five designated activities (e.g. those who help clients who buy or sell real estate; help create, manage or operate legal persons; or establish or manage trusts or hold client's money).[62] The document was well received by the legal profession in that it adopted a risk-based approach (as opposed to the more detailed rules-based approach). A risk-based approach acknowledges that there is no "one-size-fits-all" solution to the prevention of money laundering and financing of terrorism. Instead, it is founded on the premise that there are finite resources to detect and sanction money laundering and terrorism finance activities. The upshot is that the greatest risks should receive the most attention. For legal professionals, this means that they should focus on their client's location, the nature of their business and the nature of the services requested when assessing whether they are engaged in money laundering or other illicit transactions. Unfortunately, it is too early to assess whether the 2008 Lawyer Guidance generated the coveted effect. It is clear, however, that differences in legal cultures and systems hamper the speedy implementation and development of the 2008 Lawyer Guidance.

The Guidance explicitly states that the scope of the terms "legal professional privilege" and "professional secrecy" should be determined by the respective countries. Since these terms have different connotations in different legal cultures, the Lawyer Guidance has not (yet) been able to create a level-playing field for legal services in international transactions.[63] In the next subsection, we will discuss various instruments that countries introduced when approaching the regulation of beneficial ownership in an effort to prevent illicit use of corporate vehicles.

[61] See Financial Action Task Force, "RBA Guidance for Legal Professionals" (2008).

[62] See L.S. Terry, *An Introduction to the Financial Action Task Force and Its 2008 Lawyer Guidance*, 2010 Journal of the Professional Lawyer 3.

[63] See L.L. Hill, *The Financial Action Task Force Guidance for Legal Professionals: Missed Opportunities to Level the Playing Field*, 2010 Journal of the Professional Lawyer 151; E.S. Podgor, *Regulating Lawyers: Same Theme, New Context*, 2010 Journal of the Professional Lawyer 191. For instance, even though it is acknowledged that professional service providers have to know the identity of their clients (especially in the context of complex cross-border structures), it was recently pointed out that it is extremely difficult to obtain information regarding foreign clients. See European Commission, Meeting with EU Private Stakeholders on Anti-Money laundering and Counter Terrorist Financing Policy, 17 February 2011.

Box 5. Beneficial Ownership in the EU Third Directive (an example)

Beneficial owner means the natural person(s) who ultimately owns or controls the customer and/or the natural person on whose behalf a transaction or activity is being conducted. The beneficial owner shall at least include:

(a) in the case of corporate entities:

(i) the natural person(s) who ultimately owns or controls a legal entity through direct or indirect ownership or control over a sufficient percentage of the shares or voting rights in that legal entity, including through bearer share holdings, other than a company listed on a regulated market that is subject to disclosure requirements consistent with Community legislation or subject to equivalent international standards; a percentage of 25% plus one share shall be deemed sufficient to meet this criterion;
(ii) the natural person(s) who otherwise exercises control over the management of a legal entity:

(b) in the case of legal entities, such as foundations, and legal arrangements, such as trusts, which administer and distribute funds:

(i) where the future beneficiaries have already been determined, the natural person(s) who is the beneficiary of 25% or more of the property of a legal arrangement or entity;
(ii) where the individuals that benefit from the legal arrangement or entity have yet to be determined, the class of persons in whose main interest the legal arrangement or entity is set up or operates;
(iii) the natural person(s) who exercises control over 25% or more of the property of a legal arrangement or entity.

4.3 Comparative overview

As discussed, three mechanisms can be used to obtain access to beneficial ownership information upon the creation of a corporate vehicle: (1) an up-front disclosure system; (2) mandating corporate service providers to maintain beneficial ownership information; and (3) primary reliance on an investigative system. In the analyzed countries, governments often rely on an up-front identification system by service providers. For instance, in Italy, corporate vehicles are generally incorporated through a public deed of incorporation, which must be drafted and executed before a public notary by the first shareholders or their authorised representatives. Under the European Directive rules, the notary must engage in an "upfront" identification process.

The private company (Perseroan Terbatas) is the choice of corporate vehicle in Indonesia, which must be established by at least two persons. In addition: (1) the incorporation documents have to be notarised before a notary public and (2) the deed of establishment must be approved by the Ministry of Law and Human Rights. The role of the notaries in the incorporation process is merely limited to the notarisation of the formation documents. They do not have an obligation to identify the founders or the beneficial owner of a founding entity under the "know your customer principles" of Law Number 8 of 2010 on Prevention and Eradication of the Crime of Money Laundering.[64] However, according to article 41 of the Law 8/2010, Indonesia's national financial intelligence unit, PPATK, is authorised to request for and obtain information from private institutions, such as lawyers, accountants and notaries, if this information is deemed necessary to prevent and eradicate money laundering activities.

China appears to use a true upfront identification system by requiring a corporate vehicle to obtain a registration certification "business license of enterprise legal person" with the State Administration for Industry and Commerce (SAIC) or a local equivalent. The registration

[64] Law Number 8 of 2010 substituted Law Number 15 of 2002 (amended by Law 25/2003) on The Crime of Money Laundering only applied to financial service providers.

certification can only be obtained after submission of the identity cards of shareholders and identification documents of officers.

The incorporation procedures in Malaysia allow for an electronic filing or lodging of documents required by the Companies Act. A person who intends to use the service must become a subscriber by paying a prescribed fee and by complying with such terms and conditions determined by the Registrar. The incorporation procedure seems to be less demanding than the incorporation procedures in Italy, China and Indonesia. However, in addition to the electronic filing facility, the Companies Act also makes it mandatory to update the information in the register of substantial shareholders and register of directors' shareholding whenever there are changes. Not complying with the relevant provisions in the Companies Act is an offense where penalty or imprisonment may be imposed against the company and/or its officers. The Companies Act also provides a facultative upfront disclosure and investigative system. Firstly, it authorises the Registrar to request for information about the owners of any share acquired or held directly or indirectly either for their own benefit or for any other company (Section 69A). Secondly, and more importantly, the Minister responsible for companies (currently the Minister of Domestic Trade in Malaysia) may initiate an investigation on the ownership of the company (Section 207) or require more information as to the persons interested in a company (Section 208).

Finally, the incorporation procedures in the United States are simple and do not generally require the provision of the names of the beneficial owners. With respect to obtaining information about corporate vehicles, the United States operates under an investigative system, under which authorities seek to obtain (through compulsory powers, court-issued subpoenas and other measures) beneficial ownership and control information when illicit activity is suspected, when such information is required by authorities to fulfill their regulatory/supervisory functions, and in other appropriate situations. Oversight authorities in specific industries at various governmental levels may require beneficial ownership information as a condition of licensure or other approval of operations.

4.4 Key findings and main messages

In order to obtain information about beneficial ownership and control structures of listed companies, there are three possible disclosure systems for obtaining extensive disclosure information about the chain of corporate vehicles that are often employed by beneficial owners to conceal their identity and intentions. There is clear evidence of a correlation between the ability to obscure the identity of beneficial owners and the use of corporate vehicles to carry out illegal activities. The incidence of illegal activities, such as money laundering and terrorist financing, carried out through corporate vehicles suggest that this type of problem cannot be ignored and may require a comprehensive solution. However, there may not be one efficient solution and the appropriate system for a particular country may change over time to conform to local conditions and company law traditions.

In this context, it is noteworthy that recently US Senators Levin and Grassley introduced for the third time the "Incorporation Transparency and Law Enforcement Assistance Act". Under this proposal, the incorporation of corporate vehicles in the United States would require the collection and retention for beneficial owners of identity information for beneficial owners (names, addresses, driver's license or passport number) of corporations and limited liability companies (LLCs) which are not publicly traded or regulated. Moreover, the beneficial ownership information would be subject to subpoena by law enforcement. Despite the fact that promulgation of the Act would lead to a significant increase of the costs of incorporating in the United States, the

Senators argue that the identification procedures will have a positive impact on the prevention of money laundering and illicit use of legal vehicles.

In practice, however, the upfront identification of a client (either by public agents or intermediaries) who wants to set up a corporate vehicle is not without difficulties. To give just one example, the identification of residents of foreign countries could severely hamper and delay the formation process. Besides the cultural resistance of some countries to deliver supporting evidence for their residents' identification, clients often provide incorrect or uncertified copies of supporting documents, which increases the transaction costs regarding the formation and operation of corporate vehicles. Despite these extra costs, professional organisations representing legal service providers are of the opinion that the identification (know your client) procedures have a positive impact on the prevention of money laundering and financing of terrorism.[65]

Still, we can observe that the company law reforms increasingly enable business parties to set up corporate vehicles without the intervention of professionals. It could be argued that this trend would only simplify the money laundering process. However, one must bear in mind that corporate vehicles, in order to conduct activities, often have to open bank accounts that require the submission of VAT and corporate ID numbers. In fact, financial institutions remain the most suitable parties to prevent and combat money laundering. In this view, lawyers and other legal professionals provide an extra layer that serves as a safety net in the prevention of the financial system for the purpose of money laundering.[66]

The above discussion leads to a conundrum for policy makers and legislatures in that they have to take at least two main objectives of the law of corporate vehicles into account that may even be inconsistent and mutually exclusive. The main objectives of the law are: (1) offer an organisational structure for parties to conduct their business in a way that is consistent with the "public interest" of society (the prevention of illicit activities), and (2) offer a corporate vehicle form that shuns formation and operation requirements, thereby spurring entrepreneurship and innovation. It appears that the latter function of company law prevails in firms operating in knowledge-intense sectors.

Given the importance of entrepreneurship and innovation, governments around the world tend to streamline and modernise their incorporation requirements in order to become more competitive and obtain a better position in the competitiveness rankings (see for example Table 8). For instance, governments introduce simplified incorporation procedures in order to make it possible to use online systems that facilitate electronic filings of new business registrations.[67] Obviously, the online systems bypass lawyers and other legal service providers in the incorporation process (see also Box 6). It should therefore come as no surprise that US Senator Levin, who in 2009 already introduced a bill that would require states to collect and maintain beneficial ownership information upon the incorporation of these vehicles, has so far been unsuccessful.

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[65] American Bar Association, *Voluntary Good Practices Guidance for Lawyers to Detect and Combat Money Laundering and Terrorist Financing*, 23 April 2010. See also L.P. Cummings and Paul T. Stepnowsky, *My Brother's Keeper: AN Empirical Study of Attorney Facilitation of Money-Laundering through Commercial Transactions*, Working Paper, 24 February 2011.

[66] It should be noted that the Third Directive explicitly acknowledges this role by stating in Article 14 of the Directive that member states may permit that legal professionals rely on client due diligence performed by trusted third parties.

[67] As discussed, entrepreneurs in Malaysia may also file incorporation documents electronically.

Table 8. Starting a Business in 2011

Economy	Procedures (number)	Time (days)	Cost (% of income per capita)
East Asia & Pacific	7.8	39.0	27.1
Eastern Europe & Central Asia	6.3	16.3	8.5
OECD	5.6	13.8	5.3
South Asia	7.1	24.6	24.5
China	14	38	4.5
Indonesia	9	47	22.3
Italy	6.3	6	18.5
Malaysia	9	17	17.5
United States	6	6	1.4

Source: International Finance Corporation and The World Bank, "Doing Business 2011, Measuring Business Regulations" (www.doingbusiness.org).

Box 6. LegalZoom

The traditional role of lawyers is vulnerable in today's fast-changing and international business environment. Clearly, new players, like online service providers, are rapidly entering the market for legal services that was until recently destined solely to law firms. Consider the following facts. LegalZoom is an online legal document provider, headquartered in California that was established by Brian Lu, Brian Lee, Eddie Hartman and Robert Shapiro in 2001. The mission behind the online provider is improving and simplifying the process of providing legal services, in particular the drafting of legal documents. LegalZoom also assist businesses in making choice of entity decisions. For instance, LegalZoom offers an LLC or Corporation Package for US$ 99.00. Since a corporation imposes specific incorporation and operation requirements on business parties, the LLC is probably better tailored to be sold as an online product. The LLC package not only includes assistance with the standard "incorporation" formalities, such as the clearance of the LLC name and the filing of the Articles of Association with the Secretary of State, but also with the customisation of the Operating Agreement. LegalZoom developed a three-step process to assist their clients: (1) the client has to complete a relatively simple questionnaire, (2) LegalZoom will review the answers and create the Operating Agreement, while at the same time the Articles of Association will be filed with the Secretary of State, and (3) the client will receive the formation documents. The questionnaire contains questions (and assistance) about the preferred state of incorporation, the company name, dissolution requirements, management structure, transfer of ownership interests, and taxation (check-the-box). The cheaper legal services are certainly attractive to smaller enterprises in that they can now forgo a visit to a more expensive and time-consuming corporate lawyer, which charges approximately US$ 1000 for a less accessible and time-consuming service.

It is only to be expected that governments, in their efforts to encourage entrepreneurship and job creation, increasingly rely on an investigative system to obtain information about beneficial ownership in corporate vehicles.[68] Arguably, such a system stands or falls with the possibility for public authorities or appointed investigators to have access to the necessary information. The Malaysian company law provisions and, to a lesser extent, Indonesia's Law Number 8 of 2010 on Prevention and Eradication of the Crime of Money Laundering contain provisions that provide for access to corporate or even beneficial ownership information by government authorities. Reforms in this area should be geared towards the improvement of intra-governmental collaborations (on both a national and an international level) to not only obtain and maintain accurate information about beneficial ownership of corporate vehicles, but also to collectively detect and deter money laundering and tax evasion.[69]

In this respect, it is worthwhile to mention the Global Forum on Transparency and the Exchange of Information for Tax Purposes. OECD member countries, in the conviction that transparency and exchange of information on an international level was needed to deter and discourage tax evasion, initially established the Global Forum. Currently, the Global Forum includes more than 100 jurisdictions. Membership is also open to non-OECD countries that endorse the following principles: (1) commitment to implement the international standard on transparency and exchange of information, (2) contribution to the budget, and, most importantly, (3) participation in the peer review process, which consists of two phases. In Phase 1, the legislative and regulatory framework will be reviewed. Phase 2 focuses on a review of the effective application of the legal framework. Box 7 provides a summary of the main conclusions of the Phase 1 report on Indonesia, which was completed in September 2011.

[68] See The World Bank (by E. Van der Does Willebois *et al*), "The Puppet Masters, How the Corrupt Use Legal Structures to Hide Stolen Assets and What to Do About It", 2011. See also The Economist, *Corruption, Grand schemes*, 29 October 2011.

[69] Intensifying intra-governmental collaboration has been very successful in Australia. Project Wickenby started in 2006 with the aim of introducing a multi-agency focus on combating illicit use of corporate vehicles. It has been very successful (as demonstrated by "more than $1.1 billion in liabilities raised, as well as increased tax collections from improved compliance behaviour by participating taxpayers following intervention by the Wickenby task force". See http://www.ato.gov.au/content/00220075.htm. See also B. Palmer, *Misuse of Corporate Vehicles for Illicit Purposes, Australian Experience,* presented at the OECD-Indonesia Policy Dialogue: Disclosure of Beneficial Ownership and Control, Bali, 5 October 2011.

Box 7. Indonesian tax regime relevant to beneficial ownership and use of corporate vehicles

Indonesia has a comprehensive income tax system for individuals and has concluded double tax treaties allowing for international exchange of information since the late 1970s. Relevant corporate bodies include companies, partnerships, foundations and co-operative societies. These entities have to apply for legal status and/or must register in the enterprise register in order to do business in Indonesia.

Ownership information has to be provided when filing the annual income tax return. However, no enforcement provisions exist for not providing updates on ownership information in respect to foundations not carrying on business and in respect to the obligations on trustees of foreign trusts to keep ownership information.

The issuance of bearer shares is not allowed. Trusts cannot be formed under Indonesian law, but a person in Indonesia may act as a trustee of a foreign trust. Such person is subject to the Anti-Money Laundering legislation and has to apply "know your customer" rules.

The Corporate Documents Law of 1997 and the tax law together ensure that reliable accounting records, including underlying documentation, be kept for a period of ten years in respect to all relevant entities and arrangements. However, a gap exists where a foreign trust not engaged in business activities in Indonesia has a trustee resident in Indonesia. Banks are obliged to keep all bank information, pursuant to the Anti-Money Laundering Legislation; in order to obtain information held by banks the Indonesian tax authorities require the name of the taxpayer to be provided.

Source: Global Forum on Transparency and Exchange of Information for Tax Purposes, Peer Review Report on Indonesia – Phase 1: Legal and Regulatory Framework, OECD 2011.

Still, however effective these reviews are, an investigative system will be of limited use to minority investors and other stakeholders in listed companies, who, as discussed, mainly rely on publicly available and instantly accessible information about the control and ownership of listed companies. It is therefore much more important that an effective enforcement and intervention system is in place to be able to ensure compliance with the disclosure and reporting regimes for listed companies in a particular country. The next Section discusses different modalities of enforcement that are available to governments and investors to ensure that accurate information about the control and ownership structures of listed companies can be obtained.

V. ENFORCEMENT AND INTERVENTION

As far as jurisdictions have mechanisms that make it possible to obtain access to beneficial ownership and control information, it is important that proper oversight and enforcement systems are available to ensure the adequacy and accuracy of the disclosed information. Enforcement can come in different forms.[70] The enforcement taxonomy as depicted in Table 9 below provides an overview of possible forms of enforcement relating to the disclosure of ownership and control structures.

Table 9. Taxonomy of enforcement and intervention

Enforcement	Public	Private
Formal (judicial)	judicial/criminal penalties and fines administrative penalties and fines remedial orders (court, securities commissions, other government agencies) public interest dissolution/strike-off	minority shareholder litigation (including derivative action) litigation initiated by other interest group/government agencies/self-regulatory agencies
Informal (non-judicial)	request for remedial action (securities commissions) public censure (securities commissions) public or private reprimand	stock price decrease losing (foreign) investors confidence

Source: Adapted from J. Armour, *Enforcement Strategies in UK Corporate Governance: A Roadmap and Empirical Assessment*. In Armour, J. and Payne, J. eds. "Rationality in Company Law: Essays in Honour of Dan Prentice", Hart Publishing, 2009.

We can distinguish four modes of enforcement: (1) formal (judicial) public enforcement, (2) informal (non-judicial) public enforcement, (3) formal private enforcement and (4) informal private enforcement. It appears that jurisdictions differ dramatically in the mix of the enforcement devices that they employ in order to secure compliance with the rules and regulations in the area of corporate governance.[71]

There are also fundamental differences in the severity of the enforcement measures. Recall, the disclosure and transparency regimes in Europe. Most Member States have introduced regulations that require domestic and, often, foreign intermediaries or shareholders in the first and subsequent layers of the shareholding structure to provide information to the listed companies. If the intermediaries or shareholders fail to provide the information, a wide variety of enforcement measures are available in the countries, varying from formal private enforcement mechanisms, such as a suspension of voting rights or a freeze of dividends, to formal public

[70] See M. Roe and H. Jackson, *Public and Private Enforcement of Securities Laws: Resource-Based Evidence*, Harvard Law School John M. Olin Center for Law, Economics and Business Discussion Paper Series. Paper 637, 2009.

[71] See R. Kraakman *et al*, "The Anatomy of Corporate Law, A Comparative and Functional Approach", Oxford University Press, 2009.

enforcement mechanisms, such as a fine for intermediaries that do not respond or even the formal withdrawal of an intermediaries' license.

Indeed, the European Directives that are discussed in this paper acknowledge that the transparency and disclosure regimes in a corporate governance infrastructure can only be effective when legal rules and other institutions secure the enforcement of and compliance with the respective legal requirements. These Directives, however, do not prescribe particular enforcement or intervention measures (let alone a sanction system to ensure compliance by controlling beneficial owners). Instead, the Directives order the Member States to implement an enforcement system that is effective, proportionate and dissuasive. If listed companies and their investors fail to report the use of control-enhancing mechanisms, the Takeover Bids Directive states that Member States shall determine the sanctions to be imposed for the infringement of the disclosure system. In a similar vein, the Transparency Directive requires that Member States implement measures and penalties to detect and (consistently) enforce compliance with the disclosure regime set out in the Directive. Moreover, it is required that Member States designate a single competent authority that will not only be responsible for the enforcement, but also for the international co-operation with other foreign authorities.[72] The authority may disclose the penalties to the public as long as disclosure is proportionate and does not jeopardise the working of financial markets.

Obviously, cross-border co-operation between authorities that are responsible for the collection, disclosure and safeguarding of information about beneficial ownership and control structures play an important role in today's globalising and internationalising world. In order to better facilitate the exchange of information on a wider scale than a single internal market, such as the European Union, associations have emerged to set up and encourage cross-border co-operation in developing and promoting adherence to generally accepted standards and best-practices as well as exchange of information. One example of such an organisation/association is the International Organization of Securities Commissions (IOSCO).

IOSCO is currently considered as an organisation that sets the standards for more than 95% of the securities markets in the world. For instance, its Objectives and Principles of Securities Regulation (IOSCO Principles) offer an important benchmark to assist national regulators in their efforts to develop an efficient and transparent securities market. The IOSCO Principles also contain recommendations to mutually increase international co-operation and the sharing of both public and non-public information among regulators.

IOSCO encouraged the implementation of these recommendations by having adopted a multilateral memorandum of understanding (IOSCO MMoU) specifically designed to facilitate the cross-border enforcement and information exchange among its signatories. The terms of the IOSCO MMoU facilitate the exchange of information and records about the identity of beneficial owners of listed companies and other corporate vehicles (see Paragraph 7 of the IOSCO MMoU). In this respect, the IOSCO MMoU arguably plays an important role in country's enforcement regime in that it ensures that investors have access to accurate, timely and cross-border beneficial ownership information. The next Section focuses on the public and private enforcement mechanisms, including the possibilities to exchange information that may exist on a country level.

[72] For instance, the "Money Laundering" Directive explicitly acknowledges the need for cross-border co-operation, including the exchange of information among FIUs, in order to obtain accurate information about the beneficial ownership and control structures and, more importantly, to ensure the proper compliance with the disclosure regime.

5.1 Comparative overview

A closer look at the beneficial ownership rules and regulations at a country level provides numerous examples of the enforcement and intervention instruments outlined above.

5.1.1 Public enforcement

All of the jurisdictions discussed in this paper devote significant resources to public enforcement. In Italy, CONSOB can impose administrative fines and measures in the event that investors and companies are not in compliance with the disclosure regime. Moreover, CONSOB can take the following formal measures: (1) suspension of voting rights and (2) imposing a fine in the amount of twenty-five thousand Euros to two million five hundred thousand Euros. Informally, CONSOB may request the defaulting shareholder to provide the necessary beneficial ownership information as soon as possible.

Another "informal" approach can be found in the United States. Although Section 21 of the Exchange Act empowers the SEC to investigate and prosecute violators of Section 13(d) of the Exchange Act, in many cases all that the SEC staff needs to do is to remind delinquent filers of their obligations and to suggest that they make their required filings as soon as possible. When an investigation is launched, the first phase is usually an informal inquiry in which the SEC staff asks suspected violators and third parties to provide information voluntarily and to co-operate with the investigation. Such informal investigations are generally conducted on a confidential basis and can often be concluded without the need to launch a formal investigation.

The formal public enforcement mechanisms in Malaysia are typically made up of fines or imprisonment or both. Depending on the breach, the relevant authorities would be the Companies Commission of Malaysia or the Securities Commission, and the matter would be brought before the commercial division of the High Courts in Kuala Lumpur. Table 10 shows the key enforcement mechanisms. Interestingly, Malaysia also relies on an apparently effective informal enforcement system. By virtue of the powers provided to it by the Listing Requirements, Bursa Securities may for instance impose informal public enforcement actions such as submitting a formal request to obtain documents for investigation purposes from the listed companies. In the event there is a breach of the Listing Requirements, Bursa Securities may take or impose any actions or penalties, as it considers appropriate. Bursa Securities is required to notify the Securities Commission of its decisions which may include the issuance of a caution letter, private reprimand, public reprimand, or letters requiring compliance. The imposition of any one or more of the actions or penalties set out in paragraph 16.19 of the Listing Requirements does not preclude Bursa Securities from later taking or imposing such further actions or penalties, as stipulated under paragraph 16.18 of the Listing Requirements, against a listed company, as Bursa Securities thinks fit.[73]

[73] The Securities Commission (SC) is empowered to take any one or more of the following actions when a person is in default in complying with the provisions of the Capital Market & Services Act 2007 or any securities laws; or fails to comply with the rules of the stock exchange, written notice, guidelines issued or condition imposed by the SC [Section 354(1) and (3)]: (1) direct the person in breach to comply with, observe, enforce or give effect to such rules, provisions, written notice, condition or guideline; (2) impose a penalty in proportion to the severity or gravity of the breach on the person in breach subject to a cap of RM500,000; (3) reprimand the person in breach; (4) require the person in breach to take such steps as the SC may direct to remedy the breach or to mitigate the effect of such breach, including making restitution to any other person aggrieved by such breach; (5) in the case of a promoter or a director of a corporation, in addition to the actions

In theory at least, the speed and flexibility of the informal public procedures are attractive measures for market players such as the listed companies and their investors. Not only do they benefit – from a cost standpoint – from lower compliance costs, but they also benefit from the inducement to settle defaults in a more informal setting. Of course, the preference for informal public enforcement measures does not make more formal public and private enforcement mechanisms obsolete and superfluous.

Table 10. Enforcement in Malaysia

Enforcement	Public	Private
Formal	Malaysian Companies Act 1965 – failure to comply with substantial shareholders requirement: (a) fines, (b) imprisonment or (c) share transfer restrictions Capital Markets & Services Act 2007 – breach of disclosure requirement may lead to a fine or even imprisonment	Malaysian Companies Act 1965 (Section 181A) – Derivative action
Informal	Listing Requirements – caution letters/reprimands Capital Markets & Services Act 2007 – official directions/reprimands	N/A

5.1.2 Private enforcement

Private enforcement contrasts with public enforcement insofar it is initiated by private actors. The Company Laws or Securities Regulations within a country's corporate governance infrastructure usually allow for the listed companies or their minority investors to challenge shareholders resolutions if the undisclosed controlling interest in the company had the decisive vote. The federal securities laws in the United States provide for express remedies in favour of private parties who claim damages as a result of specific violations of the federal securities laws. In the United States, shareholders and companies have the right to bring private actions in federal court against persons that violate their Section 13(d) beneficial ownership reporting obligations or that commit other violations of the Exchange Act.

The private enforcement of the disclosure regime regarding ownership and control structures are arguably important to protect minority investors in the context of listed companies in a blockholder system. In order to bring an action for the controlling shareholder's breach of "fiduciary duty" to provide the company and its minority investors with adequate information, some jurisdictions, like Malaysia, provide for what is known as a "derivative suit". From the standpoint of the defendant, the incentives for bringing these actions depend on the nature and character of the litigation and the size of the award. These derivative suits are brought by one or more shareholders in the name of the company and for the benefit of the company as a whole. A misappropriation of company assets claim falls within the realm of derivative actions. It goes without saying that these actions are often necessary to block the attempts of controlling shareholders to profit from self-dealing transactions with the company, since, as we have seen, the managers are often largely controlled by the blockholders.

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taken above, the following may also be taken by the SC: (a) imposing a moratorium on any dealing by the promoter or director in the securities of the corporation; or (b) issuing a public statement to the effect that in the SC's opinion, the retention of office by the director is prejudicial to public interest. Where the SC takes an action against any person under the rules of the stock exchange, the SC shall give a written notice to the stock exchange of the grounds and the proposed action to be taken [Section 354(6)].

However, derivative suits have high litigation costs and great uncertainty. The success of these actions depends on minority shareholders' access to beneficial ownership information, the incentives provided to lawyers and the sophistication of the court system. Even where the court system is sophisticated and operates in a business-friendly environment, actions involving relief for minority shareholders are often frustrated, due to the costly and burdensome procedures. In order to improve access to the derivative suit option, the Malaysian Companies Act provides for the court to make such orders it thinks appropriate including an order for any person to provide assistance and information to the applicant including to allow inspection of the company's books [Section 181E(1)(c)]. Despite the fact that the Companies Act contains statutory safeguards to protect the rights and interest of minority investors, it is acknowledged that the effectiveness of these safeguards requires more awareness amongst shareholders in Malaysia with respect to their rights and remedies.

In this respect, it is imperative to supplement private enforcement mechanisms with public procedures to enhance the protection of minority shareholders rights. Again, the use of public enforcement mechanisms holds out the advantages of the predictability and legal certainty of formal public enforcement along with the flexibility and acceptance of informal public enforcement mechanisms.

5.1.3 Cross-border co-operation and information sharing

As discussed, internationalisation of and innovations in financial markets call for greater collaboration between national securities regulators and other enforcement bodies. Because foreign ownership in domestic stock markets is increasing,[74] there is an urgent need for enhanced investor protection through strengthened information exchange and co-operation in enforcement against misconduct and in supervision of financial markets and market intermediaries. It should therefore come as no surprise that the countries discussed in this paper are not only a member of IOSCO, but also signed the IOSCO MMoU. The exception is Indonesia, which is a member of IOSCO, but is in the process of seeking the legal authority and formal approval to become a full signatory of the IOSCO MMoU.[75]

If we accept the idea that financial markets become increasingly internationally oriented and complex, then the introduction of information sharing "obligations" in the national laws and regulations is likely to further stimulate cross-border co-operation in the enforcement of rules that are designed to protect the interests of minority investors and other stakeholders in listed companies. Consider Section 150(2) of the Malaysian Securities Commission Act 1993, which provides that the Securities Commission may, upon receiving a written request from a foreign supervisory authority for assistance to investigate into an alleged breach of a legal or regulatory requirement which the foreign supervisory authority enforces or administers, provide assistance to the foreign supervisory authority by carrying out investigations of the alleged breach of the legal or regulatory requirement or provide such other assistance to the foreign supervisory authority as the Securities Commission sees fit.

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[74] See C.T. Hin, *Foreigners Boost Ownership of Malaysian Stocks to Two-Year High, CIMB Says*, Bloomberg, 27 October 2010. See also S. Ghon Rhee and J. Wang, *Foreign Institutional Ownership and Stock Market Liquidity: Evidence from Indonesia*, Working Paper, December 2008.

[75] The Indonesian Capital Market Supervisory Agency (BAPEPAM) is listed in Appendix B of the IOSCO MMoU.

Likewise, Section 24(c) of the Exchange Act in the United States allows the SEC to make non-public information and records available to persons the SEC deems appropriate, including domestic and foreign counterparts, if they have a need for the information and make appropriate assurances of confidentiality. The SEC has adopted Rule 24c-1 under Section 24(c), which provides that the SEC can provide non-public information to a federal, state, local or foreign government and even to a foreign financial authority. Under Section 21(a)(2) of the Exchange Act, the SEC can assist a foreign supervisory authority if the foreign authority states that it is conducting an investigation to determine if its laws have been violated. The SEC may provide information in its public files, and, under Section 21(a)(2), it may collect information and evidence requested by the foreign securities authority. The SEC, for example, may compel the production of evidence and testimony on behalf of the foreign supervisory authority. Arguably, national legal rules designed to enable information sharing on an international level better establish mutual reciprocity and collaboration among national supervisory authorities.

5.2 Key findings and main messages

In view of the factors discussed above, the challenge is to find the right mix of informal and formal public enforcement measures that encourage controlling beneficial owners to effectively make disclosures and inform other investors and the market about their identity and intentions. In the spirit of finding the right mix, it is very important to consider the introduction of a segmented enforcement framework. Arguably, informal enforcement mechanisms, such as "information requests" and private and public reprimands play an important role in this framework. The flexibility of the disclosure and enforcement regime has the advantage of giving governments and supervisory authorities the opportunity to respond quickly. More importantly, it brings them closer to the market and the business community. This has the obvious benefit that governments and supervisory authorities are more inclined to engage the business community in their regulatory efforts, which is necessary to create effective rules.

Indeed, several reasons suggest that informal enforcement forms an effective means to manage non-compliance with disclosure and reporting rules and regulations in a globalising and increasingly complex world. Particularly, informal public enforcement holds out the possibility of resolving conflicts through co-operative engagement involving both public agents and private companies, offering them a variety of softer mechanisms to manage specific problems.[76] This may result in greater consistency in disclosure across listed companies that will benefit minority investors and other stakeholders across the board. There is at least a suspicion that informal enforcement measures are likely to be more effective, given the complexity of investment structures pursued by beneficial owners, than direct formal intervention.

It is crucial to recall that the challenge here is to comprehend the amount of work required by government regulators to simply understand the impact of their intervention and its ultimate effectiveness on the financial market. For an enforcement system to be successful, consideration must be given to measures that encourage the dialogue and information sharing between supervisory authorities and private actors so as to ascertain greater compliance with the disclosure and reporting standards in the international financial marketplace. Again, the introduction of informal, non-judicial, enforcement measures is pivotal in this respect. The non-judicial enforcement system reduces the burden on regulators and supervisory authorities, is quick and effective, brings regulators and supervisory authorities closer to the business community, and encourages cross-border co-operation.

[76] See J.M. Mendoza, *The Untapped Potential of Alternative Markets*, 6, Capital Markets Law Journal 364, 2011.

VI. CONCLUSIONS

This comparative paper has focused on disclosure and transparency regimes regarding the beneficial ownership and control structures employed by listed companies in a number of countries, such as China, France, Indonesia, Italy, Malaysia and the United States. We have seen that it is vital to implement clear disclosure rules that require substantial beneficial owners to disclose their identity and sometimes even their intentions. It appears to be generally accepted that disclosures should be made if direct or indirect holdings of a class of securities cross a 5% threshold. Still, the definition of beneficial owner must be sufficiently flexible and proportionate to allow the definitions to evolve as needed to adopt to changes in market behaviour, thereby enabling regulators and supervisory authorities to include investors that use innovative financial instruments only with an eye to exert control over listed companies.

As discussed, the focus a country's disclosure regime should be on control. It is therefore absolutely crucial that control-enhancing mechanisms are disclosed on a regular basis. For instance, in the United States, special control structures that deviate from the standard rule that voting rights (control) equals cash-flow rights (ownership), such as multiple voting shares, should be disclosed annually and prominently in the financial statements and on the websites of listed companies, and updated promptly if there are any changes.

Since controlling beneficial owners frequently make use of local or offshore corporate vehicles to hide their identity from the public and other investors, a closely related issue was also discussed, namely the disclosure of beneficial ownership of these corporate vehicles. This paper reported on multilateral and domestic initiatives to combat the misuse of corporate vehicles for illicit purposes. Evidently, there is a relation between the ability to hide the identity of beneficial owners from supervisory authorities and the use of corporate vehicles to carry out illegal activities. The incidence of these illegal activities suggests that this type of problem cannot be ignored and may require a comprehensive solution. However, offering a clear-cut and workable solution is difficult and does not appear to rise immediately to the top of legislatures' reform agendas. The reason for the reluctant attitude is clear: There is a trade-off between the relative ease to establish new corporate entities and the illicit use of these vehicles.

It is imperative that substantial beneficial owners comply with the existing disclosure rules and regulations that apply to listed companies. In this respect, enforcement and possibilities to intervene when ultimate beneficial owners fail to abide by these rules and regulations are crucial to the quality of a corporate governance infrastructure. We have seen that there are limitations on private enforcement actions by individual investors. These investors are therefore likely to resort to public enforcement actions by governmental agents, such as financial market regulators, or private institutions with quasi-governmental powers, such as stock exchanges.

This paper points out the importance of the informal public enforcement and intervention approach in providing a high level of disclosure and transparency in (emerging) financial markets. By choosing to informally intervene, the government is able to act in a speedy and decisive manner, thereby improving the corporate governance infrastructure in which companies operate. Moreover, there is at least a suspicion that a proportionate and flexible disclosure regime supplemented by informal public enforcement measures is, in the long run, more effective.

Governments' informal interaction with listed companies and their investors and other stakeholders in a more informal setting will lead to a better understanding of the controlling owners' instruments and intentions. Also, it will provide better insights into innovative and complex ownership and control structures (such as cash-based equity derivatives) in the ever changing and internationalising financial markets. In view of the factors discussed above, the challenge is thus to find the right mix of informal and formal enforcement mechanisms that encourage beneficial owners to effectively make disclosures and inform the company, other investors and the market about the control structure and their intentions.

In this comparative paper, we have thus set out five important recommendations for improving the disclosure and reporting regime for beneficial owners in listed companies and for developing incentives for these owners to comply with the legal and regulatory measures:

1. A good corporate governance infrastructure should increase the involvement of large investors and at the same time provide legal protection for minority investors and other stakeholders. Clearly, minority investor protection will be challenging without access to reliable information about the ownership, including the identity of the controlling owners, and control structures of listed companies. Still, despite clear benefits, a disclosure and reporting regime has its costs as well. We have seen that the design of a balanced and proportionate disclosure and reporting regime poses something of a challenge. For instance, in order to have practical relevance, the disclosure and reporting requirements should be complemented with *de jure* and *de facto* investigation and enforcement mechanisms.

2. In order to provide minority investors and other stakeholders with the necessary information about the beneficial ownership and control structures of listed companies, the ultimate beneficial owners should comply with clear and accessible rules that oblige them to provide transparency in the different layers of shareholdings. Overly stringent rules and regulations could have a counterproductive effect. Indeed, disproportionate transparency requirements not only discourage engagement of outside blockholders, such as institutional investors, but also exacerbate the information overload that already exists in the financial markets. The reason why flexibility and proportionality must prevail in a country's disclosure and reporting regime is twofold. Firstly, a flexible regime, either by offering the possibility to determine beneficial ownership on a "case-by-case" basis or by creating opt-in rules for regulators, has the benefit of making the disclosure and reporting regime adaptable to technological and market changes. Secondly, and related to this, a flexible regime ensures that beneficial owners that use derivative arrangements to seek control over a listed company can be better targeted.

3. Disclosure and reporting is particularly important when it involves information about control of listed companies. It is therefore necessary that disclosure rules and regulations require blockholders to report the use of control-enhancing mechanisms. Tightening the disclosure regime will not only lead to more transparency, but will at the same time decrease the use (and popularity) of these mechanisms. Still, the use of control-enhancing mechanisms in younger high-tech and family-owned listed companies seems to suggest that the market is able to distinguish between companies that legitimately and proportionally implement control mechanisms and companies with disproportional or inefficient structures.

4. Minority investors and other stakeholders who have an interest in pursuing an investigation in the control structures in listed companies could turn to the rules that

protect society against money laundering and financing of terrorism. Because controlling beneficial owners usually use national and/or offshore corporate vehicles to hide their identity, anti-money laundering and anti-terrorism financing legislation arguably assist minority investors in their effort to reconstruct the control structure of a listed company. However, even the most effective anti-money laundering and anti-terrorist financing system – which includes a sophisticated cross-agency collaboration framework – be of limited use to minority investors and other stakeholders in listed companies who have to rely on publicly available and instantly accessible information about the control and ownership of listed companies.

5. The final claim is that it is imperative that an enforcement and intervention system is in place to ensure compliance with the disclosure and reporting regime in a particular country. In order to be effective, the disclosure and reporting regime should be supplemented with a mix of public and private investigation and enforcement mechanisms that encourage beneficial owners to make regular and timely disclosures about the control structure and their identity and intentions. In the spirit of finding the right mix, governments should ideally introduce and develop non-judicial, informal enforcement mechanisms, such as “information requests” and private and public reprimands. In this light, it is also important that legislatures, regulators and other rule-making agents support international collaboration activities and cross-border exchange of information, such as the adoption of IOSCO’s multilateral memorandum of understanding. To be sure, material information about controlling beneficial ownership is often available through the stock exchange’s or supervisory authority’s website. However, the access to non-public information could be equally important in the investigation process. Therefore, it is argued that the implementation of a cross-border information-sharing regime is key to the proper enforcement of a country’s disclosure rules and requirements.

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ANNEX

QUESTIONNAIRE

THE FIRST STEP IN CORPORATE GOVERNANCE: THE DISCLOSURE OF OWNERSHIP AND CONTROL

The questionnaire

Thank you for participating in this survey on corporate governance and the disclosure of ownership and control in listed companies. It is generally accepted that disclosure legislation and regulation is crucial to directly or indirectly detect and discipline opportunistic and abusive behavior by controlling shareholders or ultimate owners of listed companies. The survey's purpose is to gather information about and evaluate the legislative and regulatory framework and practice, as well as the associated enforcement, regarding the disclosure of ownership and control structures in your jurisdiction. Your valuable input will be included in a substantive comparative report. The questionnaire is divided in two parts, (a) The Legal and Regulatory Regime and Practices and (b) Enforcement, and contains 15 questions.

Thank you again for taking the time to participate in this survey. We look forward to receiving your responses **before 14 July 2011.** Kindly send them to: **fianna.jesover@oecd.org**, senior policy analyst, OECD **with cc: anne.nestour@oecd.org.**

The Legal and Regulatory Regime and Practices

I. Corporate governance and minority shareholders

In listed companies with majority or controlling shareholders, the challenge is to ensure that the interests of minority shareholders are adequately protected. In order to detect and discipline possible conflicts of interest, such as opportunistic related party transactions, it is important to understand the true picture of ownership and control structures and, more importantly, to know the identity of the persons who should be considered as the ultimate owner and/or controlling person.

This picture is often blurred due to the lack of legal requirements to disclose and give insights in the use of complex structures that often obscure the link between ownership and control – most disclosure is made at the level of direct shareholders (including custodians). For instance, control-enhancing mechanisms (such as pyramid structures, cross-holdings, non-voting shares, derivative products of shares (depository receipts), and shareholder coalitions and agreements) are often employed by listed companies. The following questions relate to the protection of minority shareholders in the corporate governance framework of your jurisdiction.

What are the primary sources of law (such as company law or securities law), regulation (such as listing rules) and practice (such as the introduction of non-binding corporate governance principles) relating to the disclosure of ownership and control structures in order to protect minority interests and prevent conflict of interests?

What legislative or regulatory provisions are in place to ensure (a) the disclosure of shareholdings, (b) the disclosure of (beneficial) ownership and control structures (for instance, are there any definitions of control?), (c) the disclosure of control-enhancing mechanisms, and (d) the disclosure of the identity of ultimate owners and/or controlling persons in a listed company? Could you please describe (a) what kind of information should be made available, (b) when this information should be made available and (c) who is responsible for disclosing the information (for instance, is there an obligation for management to provide information about the company's ownership and control structure or use of control-enhancing mechanisms)?

3. Could you please indicate (a) to whom (for instance, which government or regulatory agency) the disclosed information should be made available and (b) for what purpose it is being used in practice?

4. Is there any legislation or regulation (or administrative rule) that enables government or regulatory agencies to obtain and share information with foreign counterparts?

5. Which government agencies or other groups are responsible for drafting and enforcing the legislative or regulatory rules and provisions regarding the disclosure of ownership and control structures?

6. Are there any influential shareholder activist groups or other interest groups that push for reforms in the area of disclosure of ownership and control structures in your jurisdiction?

7. Are there any judicial, administrative or other proceedings under which minority shareholders could seek to obtain information about the ownership and control structures in listed companies?

II. Corporate governance and the misuse of corporate vehicles for illicit purposes

Corporate governance is not only an issue pertaining to the protection of minority shareholders, but it also concerns the interests of other stakeholders of a company and the society as a whole. In this respect, it is important to note that there have been increasing concerns about the degree to which legal corporate entities, including corporations, trusts and foundations, are used for tax evasion, money laundering and other illicit and abusive transactions.

The disclosure of ownership and control information related to the establishment and operation of a particular domestic corporate entity (or, in the event of foreign direct investment, a foreign corporate entity) could also be crucial to understand complex ownership structures and arrangements in listed companies. Whilst misuse of corporate entities is difficult to discover, it is acknowledged that (potential) misuse can be limited by the maintenance and sharing of information on (beneficial) ownership and control through a number of legal and regulatory measures. These measures include: (1) an up-front disclosure of (beneficial) ownership and control structures to the authorities, (2) mandating corporate service providers to maintain (beneficial) ownership and control information and (3) primary reliance on an investigative system.[77] The following questions attempt to determine which measures are used in your jurisdiction:

8. Does an up-front disclosure system exist in your jurisdiction?[78] If so, could you please provide the following details about the system: (a) the type of information that is collected and maintained, (b) the means of obtaining the information (for instance, copies of share registries, tax filings, and annual reports), (c) the maintenance of the information (measures to keep the information up-to-date), and (d) practical relevance of the system?

9. Are corporate service providers in your jurisdiction required to maintain (beneficial) ownership and control information?[79] If so, could you please provide the following details about the system: (a) the type of information that is collected and maintained, (b) the means of obtaining the information (for instance, copies of share registries, tax filings, and annual reports), (c) the maintenance of the information (measures to keep the information up-to-date), and (d) the practical relevance of the system?

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[77] See OECD, Options for obtaining beneficial ownership and control information, 1 September 2002.

[78] An up-front disclosure system requires the disclosure of the beneficial ownership and control of corporate entities to the authorities, chambers of commerce or any other institutions charged with responsibility at the establishment or incorporation stage and imposes an obligation to update such information on a timely basis when changes occur. The obligation to report beneficial ownership and control information to the authorities may be placed on the corporate entity, the ultimate beneficial owner, or the corporate service provider involved in the establishment or management of the corporate entity.

[79] In some jurisdictions, intermediaries involved in the establishment and management of corporate entities, such as company formation agents, trust companies, registered agents, lawyers, notaries, trustees, and companies supplying nominee shareholders, directors, and officers ("corporate service providers"), are required to obtain, verify, and retain records on the (beneficial) ownership and control of the corporate entities that they establish, administer, or for which they provide fiduciary services.

10. Does your jurisdiction (also) rely on an investigative system to obtain ownership and control information about domestic or foreign corporate vehicles (in the event of foreign direct investment)?[80] If so, could you please provide the following details about the system: (a) the type of information that is collected and maintained (for instance, foreign direct investment or transfer pricing information), (b) the means of obtaining the information (for instance, copies of share registries, tax filings, and annual reports), (c) the maintenance of the information (measures to keep the information up-to-date), and (d) the practical relevance of the system?

Enforcement

As far as jurisdictions have mechanisms that make it possible to obtain access to (beneficial) ownership and control structures, it is emphasized that proper oversight and enforcement of the disclosure systems are also necessary to ensure the adequacy and accuracy of the information. Enforcement can come in different forms. The enforcement taxonomy as depicted in the figure below provides an overview of possible forms of enforcement relating to the disclosure of ownership and control structures.

Enforcement	Public	Private
Formal	(i) judicial/criminal penalties and fines (ii) administrative penalties and fines (iii) remedial orders (courts, securities commissions, other government or regulatory agencies) (iv) public interest dissolution/strike-off	(i) minority shareholder litigation (ii) litigation initiated by other interest group/government or regulatory agencies
Informal	(i) private request for remedial action (securities commissions) (ii) public censure (securities commissions)	(i) negative stock price reactions (ii) losing (foreign) investors confidence/loss of reputation

11. If disclosure of beneficial ownership and control structures is required, are there any "**formal public enforcement**" mechanisms, including the power of discovery and inspection, to enforce the legal and regulatory regimes? If so, (a) which court or other institutions have jurisdiction in these proceedings/cases, (b) who may initiate the enforcement proceeding or action, (c) against whom may enforcement actions be taken, (d) what are the main types of enforcement actions taken, (e) are these actions effective and do they have any practical relevance?

12. If disclosure of beneficial ownership and control structures is required, are there any "**formal private enforcement**" mechanisms, including the power of discovery and inspection, to enforce the legal and regulatory regimes? If so, (a) which court or other institutions have jurisdiction in these proceedings/cases, (b) who may initiate the enforcement proceeding or action, (c) against whom may enforcement actions be taken,

[80] Under an investigative system, the authorities seek to obtain (through compulsory powers, court-issued subpoenas, and other measures) beneficial ownership and control information when illicit activity is suspected, when such information is required by authorities to fulfill their regulatory/supervisory functions, or when such information is requested by other authorities domestically and internationally for regulatory/supervisory or law enforcement purposes.

(d) what are the main types of enforcement actions taken, (e) are these actions effective and do they have any practical relevance?

13. If disclosure of beneficial ownership and control structures is required, are there any "**informal public enforcement**" mechanisms to enforce the legal and regulatory regimes? If so, (a) which institutions (and when) may initiate these informal public enforcement actions, (b) what are the main types of enforcement actions taken, (c) against whom may enforcement actions be taken, (d) are these actions effective and do they have any practical relevance?

14. If disclosure of beneficial ownership and control structures is required, are there any "**informal private enforcement**" mechanisms that help enforce the legal and regulatory regimes?

15. Is there any data (or references to relevant cases) available on actions brought, remedies awarded and penalties imposed related to the disclosure of beneficial ownership and control structures?