



## **ENHANCING TRANSPARENCY OF BENEFICIAL OWNERSHIP OF HONG KONG COMPANIES**

### **The Law Society's Submissions**

The Law Society has reviewed the captioned consultation paper issued by the Financial Services and the Treasury Bureau (FSTB) in January 2017 ("Consultation Paper").

The conceptual framework underpinning the proposals is said to be aimed at preventing illicit activities, improving corporate accountability and, therefore, hopes to enhance the competitiveness of Hong Kong companies (paragraph 2.1 of the Consultation Paper). These are laudable and overarching principles which, of themselves, the Law Society supports. However, we have much reservation with the legislative amendments proposed to achieve the above, e.g. among others, to impose statutory obligations upon the Hong Kong companies to obtain and hold up-to-date beneficial ownership information for public inspection upon request (para 3.1).

The details of our above views, together with our comments on those questions posed in the Consultation Paper (set out in Chapter 4 of the Consultation Paper), are set out in the following submissions.

***1. Do you agree that enhancing transparency of company ownership is important for ensuring that Hong Kong remains an open, trusted and competitive place for doing business?***

#### **Law Society's response:**

No, not in this context. Information on corporate beneficial ownership is imparted by a variety of means in the business world. Enhanced transparency mandated by a statutory disclosure regime does not add much to the trust and confidence building process for persons engaged in business dealings.

In fact the introduction of a statutory disclosure regime will make Hong Kong *less*

competitive, as investors will be driven to jurisdictions for formation of companies where the regulatory burden for forming and maintaining companies is less stringent. It increases compliance costs for small private companies and also creates security risks for high net worth individuals.

In general, we share the opposing views expressed by the Law Society of England and Wales in its response (<https://www.lawsociety.org.uk/policy-campaigns/consultation-responses/transparency-and-trust-law-society-response/>) to the Transparency & Trust: Enhancing the Transparency of UK Company Ownership and Increasing Trust in UK Business Discussion Paper put out by the UK Government in 2013. Some of the key points made by English Law Society, which are equally applicable in the Hong Kong context, are highlighted below:

- (a) The effectiveness of statutory disclosure regime in averting the misuse of companies by persons engaged in criminal activities is *questionable*, as it is not likely that criminals would be in compliant.
- (b) The purpose of the statutory disclosure regime is to aid law enforcement agencies in their investigation of identity of known or suspected criminals who conceal the true purpose of an account or property, or the source or use of certain funds held through companies. Inadequacies in investigative powers of law enforcement agencies can and should be *addressed by enhancement of those powers*, rather than imposing further burdens on law abiding investors or companies.
- (c) It is a fundamental principle of English common law and natural justice that people should be entitled to privacy, unless there is an overriding public interest issue that requires otherwise. Apart from the government's desire to match international standard on corporate beneficial ownership disclosure, there is *no* public interest at play that requires intrusion into a person's privacy.

**2. *Do you agree that a balanced approach to legislation should be adopted, so as to ensure that our business environment stays competitive while we fulfil our international obligation to enhance transparency of company ownership?***

**Law Society's response:**

For reason expressed in our response to question 1 above, we are not convinced that Hong Kong should adopt a statutory regime for disclosure of corporate beneficial ownership.

Undoubtedly Hong Kong has an obligation as a Financial Action Task Force

(“FATF”) member to implement Recommendation 24 on transparency and beneficial ownership of legal persons. On this front, Hong Kong does not need to strive to be the forerunner but should at least wait until China and the United States, as the two largest economies, have taken measures for implementing Recommendation 24. In the case of the United States, according to the Anti-money Laundering and Counter-terrorist Financing Measures - United States, Fourth Round Mutual Evaluation Report (<http://www.fatf-gafi.org/publications/mutualevaluations/documents/mer-united-states-2016.html>), United States was rated non-compliant on Recommendation 24 as at December 2016.

China was rated non-compliant on Recommendation 24 as well, as at February 2012, according to the Mutual Evaluation of China: 8th Follow-up Report (<http://www.fatf-gafi.org/media/fatf/documents/reports/mer/Follow%20Up%20MER%20China.pdf> )

For the sake of agreement, if Hong Kong must adopt a statutory regime for disclosure of corporate beneficial ownership, any balanced approach to be taken should not result in disclosure regime which is more stringent than our competitors.

***3. Do you agree with the proposed scope of application, i.e. covering all companies incorporated in Hong Kong, except listed companies regulated under the Securities and Futures Ordinance?***

**Law Society’s response:**

Agreed, if Hong Kong is to adopt a disclosure regime.

On non-Hong Kong companies registered under Part 16 of the Companies Ordinance, we agree that the statutory disclosure regime should not apply to them. Such regime may deter foreign investors from coming to Hong Kong to do business if there is no similar disclosure requirement applicable to entities formed in their home jurisdiction. Disclosure of beneficial ownership in registered non-Hong Kong companies should be left to their home jurisdictions.

***4. Do you think that there should be an exemption for certain types of companies? If so, which, and why?***

**Law Society’s response:**

Companies that do not pose any risk of money laundering nor terrorist financing should be exempted. The following types of companies should qualify for the exemption:

- (a) all dormant companies qualified under section 5 of the Companies Ordinance;
- (b) any company that does not trade, does not hold share in any other company, has no bank account and has total assets not exceeding a prescribed threshold;
- (c) any subsidiary of a company listed in Hong Kong; and
- (d) companies that are subject to SFC, HKMA, or OCI licensing requirements.

**5. Do you agree with the proposed definition of beneficial ownership, which takes into account the FATF's recommendations and the thresholds commonly adopted by other member jurisdictions?**

**Law Society's response:**

We generally agree with the proposed definition of beneficial owner set out at paragraph 3.4 of the Consultation Paper, save for importation of the term "significant influence or control". Such term is not used nor defined in the Companies Ordinance or the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance ("AMLO"). Unless the term is defined with precision and in straight-forward language, complex issues of interpretation may arise, leading to legal uncertainties, risks and added compliance cost. None of these is desirable. The UK Government has tackled this problem by issuing a statutory guideline on interpreting "significant influence or control" in the context of their disclosure regime. In the interest of reducing compliance burden and associated costs, we should endeavour to codify the meaning of "significant influence or control" in definitive terms.

In the case of companies structured in a group with multiple layers, there should be clarity that the chain is recognized on the basis of 50% plus ownership or control. Sections 13 and 15 of the Companies Ordinance should continue to apply.

**6. Do you agree with the proposal of adopting more than 25% as the threshold for determining beneficial ownership?**

**Law Society's response:**

The ownership threshold applicable under the AMLO under normal situations for carrying out customer due diligence measures on beneficial owners is 25%. In high risks situations, the lower threshold of 10% applies. See sections 2(2) and 15 of Schedule 2 to the AMLO. There is no apparent regulatory reason for altering the 25% threshold.

**7. Do you agree with the proposed content of the register of People with Significant Control (“PSC register”), which shall include registrable individuals and registrable legal entities which meet the relevant conditions in respect of beneficial ownership?**

**Law Society’s response:**

We disagree with the proposal contained in paragraph 3.7 of the Consultation Paper. A “registrable legal entity” should not be required to be made the subject matter of an entry in the PSC register. In the case of multiple layers of intermediate holding companies, disclosure of the bottom most layer does not add much to understanding the holding structure. The purpose of the disclosure regime is to identify the natural persons who are beneficial owners, not to explain how a person owns or controls his business/investment.

**8. Do you agree with the proposed format of keeping the PSC register and the required particulars?**

**Law Society’s response:**

If no registrable individual is known to the company, PSC register can be left empty. A negative statement is entirely superfluous.

We question the regulatory reason for including disclosure on correspondence address of the beneficial owner. The company itself should of course have a right to seek correspondence address from the beneficial owner but such information should not have to be on the PSC register, unless it is intended that the beneficial owner should be reachable by members of the public and can be made answerable for more enquiries. If such information is on the PSC register, any change will have to be up-dated to the PSC register. This poses an unnecessary administrative burden on the company maintaining the PSC register.

The disclosure on nature of control should be no more than a matter of checking the relevant boxes indicating the applicable conditions that render the person a beneficial owner.

**9. Do you agree with the ten-year record-keeping requirement?**

**Law Society’s response:**

We agree that the retention period should be on par with that applies to register of members.

**10. Do you think companies should be given the choice to meet the requirement of nominating a person for cooperation with law enforcement agencies by authorising a natural person resident in Hong Kong or a local designated non-financial business and professional (“DNFBP”) (viz. solicitor, accountant, or trust and company service provider) who would have to be regulated under the AMLO?**

**Law Society’s response:**

Yes, if Hong Kong is to adopt a disclosure regime.

**11. Do you agree with the proposed manner of keeping the PSC register (i.e. at the registered office of a company or any other place in Hong Kong)?**

**Law Society’s response:**

Agreed, if Hong Kong is to adopt a disclosure regime.

**12. Do you agree that the PSC register should be available for public inspection?**

**Law Society’s response:**

We disagree with this proposal.

The Consultation Paper states that the reason for enhancing transparency is to facilitate such information to be accessible in a timely fashion by competent authorities (see paragraph 1.7 and 2.3 of the Consultation Paper). Following this rationale (if accepted), if Hong Kong is to adopt a disclosure regime, then the PSC register should only be made available to competent authorities tasked with combating money laundering and terrorist activities *instead of* to the public at large. If the PSC register is generally available for public inspection, it will easily be open to abuses, impede legitimate commercial confidentiality and thus undermine Hong Kong's attractiveness as a jurisdiction for incorporation. This is most undesirable.

In any event, we note no cogent reasons have been presented to show why the PSC register should be available for public inspection.

**13. If not, whether the PSC register should be accessible only to competent authorities? Why? Why not?**

**Law Society's response:**

Please see our views on Question 12 above. We repeat our disagreement with the proposal to open the PSC register (if established) to the general public.

***14. Do you agree with the proposed sanctions on companies for non-compliance with the requirements for keeping a PSC register and making available the PSC register for public inspection, and in respect of the making of false statements?***

**Law Society's response:**

We do not agree that the PSC register should be open to the public. We agree that sanctions for non-compliance with the requirements for keeping a PSC register and making it available for inspection, if it is to be open for public inspection, should be in line with that in respect of register of members, directors and company secretaries.

***15. Do you agree with the proposed sanctions on a notice addressee who has been served with a notice to confirm beneficial ownership for failing to comply with the notice, and in respect of the making of false statements in the reply to the notice?***

**Law Society's response:**

We disagree that criminal liability should be imposed on a notice addressee for failing to comply with a notice. To do so would enable all Hong Kong private companies to issue notices to a potentially broad range of persons seeking confirmation on beneficial ownership and to initiate criminal prosecution for failing to comply. Such power can be abused and the result can be chaotic. The proposal is tantamount to giving quasi-expropriation rights to a private company on the basis of suspicion, albeit reasonable suspicion. It is highly problematic for a private company, without judicial powers and not specifically subject to natural justice principles, and which does not necessarily have in place a good corporate governance regime, to be able to exercise such rights.

***16. Do you think companies should be allowed the option of restricting the participation and/or pecuniary rights of persons when the latter fail to respond to a notice of confirmation?***

**Law Society's response:**

Negative. Any sanction that a company is able to impose would have to be on its

registered shareholders. Notice issued by a company making enquiries on its beneficial ownership is based on what the company claims to know or claims to have reasonable cause to believe. That being the company's status of knowledge, it is not possible for the company to link the non-responsive addressee to a particular registered shareholder.

***17. Do you agree that a rectification mechanism should be included to enable applications to the court from anyone aggrieved by the entry in or omission from a PSC register as a registrable individual or a registrable legal entity?***

**Law Society's response:**

Agreed.

**The Law Society of Hong Kong  
7 March 2017**