

30 June 2010

REGULATORY IMPACT STATEMENT

COMPANY REGISTRATION PROCESSES

AGENCY DISCLOSURE STATEMENT

This Regulatory Impact Statement has been prepared by the Ministry of Economic Development. It provides an analysis of a limited range of statutory measures designed to strengthen company registration processes in order to improve the reputation of New Zealand's company registration system, and gives the Registrar of Companies enhanced powers to respond to risks which might arise in relation to the integrity of information recorded on the companies register.

There is separate work being undertaken by officials in the Anti-Money Laundering context which will make recommendations on other measures (including additional substantive changes to the operation of company formation agents) aimed at reducing the abuse of the New Zealand corporate form by offshore interests. The statutory measures in this paper deal only with a range of changes to the company registration regime under the Companies Act 1993 that can be made quickly.

The analysis undertaken includes consideration of the known crime statistics in relation to New Zealand registered companies operating offshore. In addition it takes into account the impact of the proposals on the overall body of New Zealand registered companies by reference to the statistics relating to the number of companies involved.

Targeted consultation, particularly with representatives of business interests such as Business NZ and the Business Law Committee of the New Zealand Law Society, also guided the options considered.

The main constraint on the achievement of the targeted outcomes is the requirement that compliance costs on legitimate businesses are not increased; that is, measures target, so far as practicable, only those offshore persons seeking to register a New Zealand company with no intention of conducting business here. A further constraint on assessing the true magnitude of the problem is the criminal nature of the activity which has given rise to the proposals. By its very nature this activity is covert and its true extent must be a matter of speculation, although it is probably safe to assume that the number of entities engaged in such activity is greater than the reported incidence brought to the attention of enforcement agencies.

The policy options will impose minimal costs on New Zealand based companies and low costs on legitimate overseas businesses from some jurisdictions which seek to operate via a New Zealand registered company. They will not impair private property rights. Whilst a very small proportion of companies (under 3% of companies on the companies register) may face a new barrier to operating in New Zealand by virtue of the requirement to appoint a New Zealand resident director or local agent, the benefits to New

Zealand's international reputation would outweigh such costs. The policy proposals will not override fundamental common law principles.

Liz Thomson
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STATUS QUO AND PROBLEM

Status Quo

The registration and administration of companies is governed by the Companies Act 1993 and its subordinate legislation.

New Zealand's company registration regime is low-cost and straightforward by comparison to foreign jurisdictions. The incorporation process is highly electronic, can be entirely completed online, and does not require directors to be present in, or resident of, New Zealand. The registration requirements of the Companies Act impose no additional entry criteria for companies which register in New Zealand but which are controlled by offshore interests, including those who do not carry on business in New Zealand. In addition, the application fee for incorporation is low by international standards, and New Zealand is unique in not imposing an ongoing annual licensing fee.

The simplicity of the regime is a contributor to New Zealand's enviable reputation for ease of doing business. Coupled with its reputation as a well-regulated jurisdiction, this provides a comparative advantage that underpins New Zealand's ability to attract and retain internationally-mobile business investment.

Problem Definition

Ironically, the confluence of low entry barriers and high international standing also makes the New Zealand registration regime vulnerable to misuse by illegitimate offshore operations. A review of the circumstances surrounding the SP Trading Ltd event² has identified a number of areas where New Zealand's regime is out of step with comparable foreign counterparts. It has further identified an inability for the Registrar of Companies to take administrative and investigative steps to ensure the integrity of the information which appears on the companies register where he is aware that such information is inaccurate.

The lack of any requirements under the Companies Act registration criteria to address the issue of wholly offshore interests being able to use the New Zealand company structure makes it very easy for these operations to use the company registration process to create a false sense of association with New Zealand. In turn, this enables such operations to enjoy a lesser degree of scrutiny than might otherwise be applied when conducting their affairs around the globe. Where these affairs are unlawful, the reputation of New Zealand in general - and its company registration regime in particular - may be tarnished

² This New Zealand-registered company was recently implicated in a weapons smuggling operation in Thailand. It has no business presence in New Zealand and its sole nominee director had signed a comprehensive power of attorney regarding the control of the company to two nationals.

by association. This has implications for the integrity of the registration regime and its appeal to legitimate offshore investment.

Further, the Companies Act 1993 (“the Act”) confers only limited powers on the Registrar of Companies to take action where he is aware that a company or its directors are failing to ensure that the information which appears on the register is accurate, and that the company is complying with its registration requirements. While the Act allows prosecution of individuals (including directors) who make or authorise false or misleading statements relating to the affairs of a company, there is no ability for the Registrar to take steps to ensure that the information relating to the company which appears on the companies register is accurate and complete.

In addition, the Reserve Bank has received frequent complaints and enquiries about “offshore financial institutions” incorporated in New Zealand but with no other connection to the country. It estimates that there are at least 1000 such companies on the register, of which a number are suspected of carrying out fraudulent activities

There are currently around 530,000 companies on the companies register, so the number of suspect companies is a small proportion of the overall body of New Zealand registered companies. The repercussions of even a very small number of high profile cases however, has the potential to cause considerable reputational damage and reduction in confidence.

If the status quo is maintained the risk of repeat examples like SP Trading Limited under the current regime is high. In cases where the illegal activity being conducted by the company involves breaches of international obligations such as United Nations sanctions, such episodes are undesirable.

Concerns relating to the exploitation of the New Zealand companies registration regime by rogue offshore interests also extends to similar concerns with the limited partnerships regime established under the Limited Partnerships Act 2008. From the inception of this regime there has been a high uptake of the New Zealand limited partnership vehicle by offshore interests which have no business presence in New Zealand and general and limited partners who are located wholly offshore. Many of registered limited partnerships are known to be carrying on business as offshore financial institutions.

OBJECTIVE

The overall objective is to make low cost changes to the registration system that would reduce the risks of a recurrence of undesirable events similar to those that arose in the SP Trading case.

OPTIONS

Option 1 - Requiring Full Identity Verification of Directors

This option would involve requiring full verification of the identity of directors of companies at the time that they are appointed. Such verification would involve the checking of a number of corroborating identification documents such as birth certificates and passports. However, this option is not being recommended because:

- It is relatively straightforward for offshore individuals who are engaged in illegal activities to falsify identity information, and relatively difficult for agencies in New Zealand to check the bona fides of identity information provided from offshore;
- Even if law enforcement agencies are able to prove that identity information has been falsified, investigation and enforcement of individuals located offshore is problematic, costly and time-consuming;
- Although the Identity Verification Service will provide assurance as to the identity of New Zealand individuals, there is currently no sufficiently developed technology to accurately verify the identity of the higher risk category of offshore directors;
- Full identity verification in and of itself would not deter determined criminal elements from exploiting the good reputation of the New Zealand companies regime.

Option 2 - Requiring Disclosure of Beneficial Control of Companies

This option would require shareholders and directors of companies to disclose information regarding the beneficial ownership of shares held on trust, as well as the identity of those who control companies in cases where directors are acting pursuant to a power of attorney or other arrangement. Such disclosure could facilitate targeted crime prevention and enforcement. This option was discounted at this time because it will be considered by officials working on the report back to FATF in October 2011.

PREFERRED OPTION

The preferred option is to introduce a combination of measures to amend the Companies Act 1993.

A Enhancing the Powers of the Registrar

Under this measure the Registrar of Companies would have enhanced powers to take administrative and investigatory action if he has reasonable grounds to believe that the company or its directors are in breach of their registration requirements. Such powers would be additional to the ability to bring a prosecution for making or authorising the making of false statements which currently exists under the Companies Act 1993.³

³ Section 377 Companies Act 1993

In summary, it is proposed that the Registrar be given the following powers:

- a** *Require companies, directors, shareholders and/or local agents to confirm or correct existing information on the companies register in situations where the Registrar;*
- b** *“Flag” publicly a company’s registration in circumstances where the Registrar has reasonable grounds to believe that:*
 - The company or its directors or shareholders have provided inaccurate information for the register, or in response to a request from the Registrar;
 - The company or its directors or shareholders are in persistent breach of the Companies Act or Financial Reporting Act;
 - The company has ceased to carry on business.
- c** *Remove a company from the Companies Register for the same reasons that he would be able to flag their registration, following a range of procedural safeguards to ensure that there is a power to object to such removal;*
- d** *Remove a director from a company if that person is disqualified under the Companies Act;*
- e** *Extend the criteria for the Registrar to impose management banning orders to include persistent non-compliance with the filing and reporting obligations of the Companies and Financial Reporting Acts or where they have provided inaccurate information to the Registrar; and*
- f** *Extend the Registrar’s investigation powers to matters where a company or its directors have not complied with the disclosure requirements of the Companies Act.*

Benefits

- Increased confidence for those searching the register regarding the accuracy and integrity of information on the register;
- Improved protection to investors, creditors and others who deal with companies by:
 - Providing a clear warning on the register when a company is under investigation for breaching its registration requirements under the Companies Act;
 - Enabling the removal of a company from the register if it fails to rectify breaches of its registration requirements;
 - Enabling the Registrar to ensure that companies do not continue to be recorded on the register as fulfilling their basic registration requirements (e.g. that they have at least one director) when in fact they do not;
 - Permitting the Registrar to remove persons who are disqualified from acting as a director from office due to the company’s failure to remove them as a director;
 - Enabling the Registrar to ban directors for a period of up to five years if they repeatedly fail to ensure that a company is fulfilling its registration requirements;
 - Making it easier for the Registrar to confirm the bona fides of those persons behind any company, and to hold any company to account for breaches of law.

Limitations

This measure will not prevent New Zealand registered companies controlled by rogue offshore interests from carrying out illegal activities. It provides only

the means for ensuring that the consequences of such activities are not exacerbated by misinformation in relation to such companies being permitted to remain on the register.

Costs

The enhanced enforcement powers of the Registrar would have cost implications (both direct and indirect) for those firms suspected of failing to comply with compliance and disclosure requirements. Such costs would include the compliance cost of correcting information on the register and reputational costs for companies which are the subject to the exercise by the Registrar of the powers outlined. This compliance cost would range from a minimal cost for submitting forms containing, for example, a correct residential address (there is no fee for filing such documents, but if professional advisors are used a fee based on such a professional's hourly rate would be incurred), up to a significant cost due to loss of business opportunities arising from the action of the Registrar in alerting the public to the fact that the company is not meeting its registration requirements.

The costs of the increased functions of the Registrar would be absorbed from within existing baseline funding.

B New Zealand Resident Director/Agent

Under this measure all companies which register in New Zealand would require at least one director to be ordinarily resident in New Zealand. This requirement is contained in the company laws of other comparable jurisdictions such as Australia, Canada and Singapore. Alternatively, rather than requiring a New Zealand resident director, a local agent could be required, who would act as a New Zealand representative of the company, with limited functions such as being able to accept service on behalf of the company and holding information relating to the company. Unlike a director, the local agent would not be responsible for the governance of the company, and would not be subject to or liable for the directors' duties imposed under company law.

It is proposed that companies whose directors are resident in approved jurisdictions should be exempted from this requirement. Jurisdictions which have entered into information sharing arrangements with the Registrar of Companies (for example, Australia) would be eligible to be exempted from this requirement.

Benefits

- Introducing the resident director requirement would bring New Zealand company law into line with Australia, Canada and Singapore;
- The duties and liabilities imposed by company law on a New Zealand director would act as a deterrent to offshore interests who do not intend to carry out lawful business. Anecdotal evidence from staff of the Australian Securities and Investment Commission indicates that they do not experience a high incidence of the misuse of the Australian company structure by offshore interests. They attribute this to the deterrent effect of the requirement under the Australian Corporations Act for at least one company director to be ordinarily resident in Australia;
- The presence of a company representative in New Zealand would provide an entry point for enforcement agents to gain information regarding the activities of the company. Under the status quo it is

difficult and costly to effectively investigate a company if all individuals are located offshore;

- The company representative would provide a point of accountability for the activities of the New Zealand company. Under the status quo there is often no identifiable and/or available individual who is liable for the actions of the company. The accountability of the resident director measure would be greater than that of the local agent, given the director's greater responsibility for the actions of the company;
- It would overcome issues relating to service on directors located offshore, which is problematic for practical and logistical reasons.

Limitations

- The presence of a New Zealand resident director or local agent will not necessarily prevent a company from engaging in illegal activities;
- As the New Zealand resident director would in some cases be appointed merely to fulfil the registration requirements for incorporating in New Zealand, a nominee director with no real role in the business may be appointed. This was the case with SP Trading Limited, which had a nominee New Zealand resident director who executed a power of attorney handing all control of the company over to individuals;
- Even if a New Zealand resident director was not a nominee, there may not be a sufficient pool of well qualified and experienced directors available to take up directorships;
- In the case of the local agent alternative, the level of accountability of the local would be minimal given the restricted role of the agent in comparison with a company director.

Costs

This requirement would not impose a regulatory cost on New Zealand-based businesses since they will have New Zealand resident directors as a matter of course.

As both New Zealand resident directors and local agents would in many cases charge fees for their services, costs would be imposed on some international businesses. It is estimated that less than 3% of the total number of companies on the register would fall into this category. This number would reduce significantly if the exemption proposal is approved (i.e. companies whose directors reside in approved jurisdictions are not required to appoint a New Zealand-resident director or local agents).

The quantum of such a fee would vary according to the type and size of any business undertaken by a company. At the lower end of the scale the fee would be around a few hundred dollars. At the upper end, the fee would be much higher – for example in the case of company with operations the size of some of our largest listed companies, fees in the hundreds of thousands are occasionally paid. Based on Companies Office statistics, nearly 95% of companies on the register can be characterised as small or medium sized businesses. The higher fee levels would therefore apply to around 5% of affected companies. Based on the weighted average of the size of most companies involved, an estimate of the compliance cost is a range of between \$500 up to \$5000 per company, with a small number of larger multinational companies liable for the higher fee which directors of such entities could expect to charge. It should be emphasised that this is an estimate, however.

Given the vast range of businesses undertaken by companies it is difficult to calculate a standard fee for such services.

In the case of a local agent it is expected that the fee would be significantly lower. A local agent would not have a role in the governance of the company, and would not be subject to the directors' duties imposed under company law. The functions of a local agent would be confined to accepting service of documents and holding information relating to the company. An estimate of the fee for an agent is in the range of \$500 to \$2000 per annum.

The costs are a justifiable regulatory burden because:

- ***Other comparative jurisdictions to New Zealand impose such requirements, therefore New Zealand would not be at a competitive disadvantage;***
- ***A number of existing businesses will have access to agents already in the form of New Zealand employees or professional advisors. All companies are required to have an address for service and registered office, and it would be a small additional step to nominate a party at that address as a local agent or director;***
- ***The limited exemption proposal will remove these costs from businesses whose directors reside in approved low-risk jurisdictions.***

There is also an element of compliance imposition on the way in which some international businesses carry out their business. A number of international companies, particularly those based in Australia, prefer to incorporate a New Zealand subsidiary and control its operation from a parent company with all members of its board of directors located in its home jurisdiction. Such entities may be reluctant to appoint a New Zealand resident director for issues of convenience, such as the logistical requirements of holding board meetings where one director is resident in New Zealand.

C Director Birth Information

This measure would require all directors to provide their date and place of birth to the Registrar of Companies. In the same way that the Limited Partnerships Act is drafted, this information would form part of the register, but would not be available for public searching. It would be able to be used by the Registrar and other enforcement agencies in order to carry out their functions under the Companies Act. There will be privacy issues around the collection of this personal information, and consultation with the Privacy Commissioner will be required.

Benefits

- Better verification of individuals against whom action may be taken (for example, in situations where two people such as a father and son, reside at the same address);
- Alignment with Australian company law, which would in turn help in facilitating the harmonisation of New Zealand and Australian company registration processes.

Costs

There is a very low financial cost for this requirement. The date of birth information would be collected by way of a field on either the form for the

application for incorporation, or the form of consent to be appointed a director, either at the time that the company is formed or when the director is appointed. Consulted parties reported that international directors expect to provide this information in any event, as it is a common requirement for overseas jurisdictions.

D Mandatory Tax Numbers

This measure would make it mandatory for all companies to apply for a tax number as part of the registration process. Under the status quo this is an option for companies, and around 80% of companies currently do so.

Benefits

- All directors would be subjected to the standard Inland Revenue Department checking processes, including its “failsafe” systems;
- The requirement would send a signal to those seeking to incorporate in New Zealand that they should be doing so with the ultimate intention of carrying on business here.

Limitations

- not all companies will be taxpayers immediately upon incorporation. For example, shelf companies formed by organisations such as legal firms, accountants or company formation agencies for on-selling to clients may not be used for the conduct of a business for some time after their formation;
- the obtaining of an IRD number will not necessarily prevent the conduct of illegal offshore activity via a New Zealand company vehicle. It is not uncommon for company formation agents to include the obtaining of an IRD number as part of the “package” of services which they provide to offshore clients.

Costs

- There is no fee for applying for a tax number, and no related or downstream costs associated with obtaining a tax number. On the contrary, the removal of duplicate processes for applying for company registration and a tax number would result in a reduction in compliance costs to firms.

Benefits of the Preferred Option

Notwithstanding the limitations to the measures discussed above, the preferred option will improve the standing of New Zealand’s company and limited partnerships registration regimes.

- Reputation: The proposals would address the perception that New Zealand’s company registration system is particularly vulnerable to incidents;
- Comparability with similar jurisdictions: the proposals would bring New Zealand’s company law registration requirements more into line with other similar jurisdictions, thus reducing the scope for it to be particular target jurisdiction for rogue offshore interests;
- Deterrence: the imposition of increased registration requirements are aimed at deterring those who view New Zealand as a jurisdiction of convenience. The fact that the registration requirements and the

Registrar's powers are being increased would send a signal that such activity is being subjected to increased scrutiny and enforcement;

- Compliance with international obligations: the preferred option would go towards reducing the risk that New Zealand companies or limited partnerships may engage in activities which may breach international obligations such as United Nations sanctions measures;
- Trans-Tasman harmonisation: the introduction of the resident director proposal and the date and place of birth proposal would bring New Zealand's company law into line with that of Australia. That in turn would facilitate the harmonisation of registration processes between New Zealand and Australia;
- Better enforcement: the resident director or agent requirement coupled with the date and place of birth information would enable enforcement agencies to undertake more effective enforcement.

LIMITED PARTNERSHIPS

Concerns relating to the exploitation of the New Zealand companies registration regime by rogue offshore interests also extends to similar concerns with the limited partnerships regime established under the Limited Partnerships Act 2006. It is therefore proposed that the same measures be applied to limited partnerships with the necessary modifications to take into account their differing legal structure (e.g. the fact that they have general partners rather than directors).

CONSULTATION

Departmental consultation

The Treasury, Ministry of Justice, New Zealand Police, Inland Revenue Department, Department of Internal Affairs, the Privacy Commissioner and Ministry of Foreign and Trade have been consulted on the contents of the paper.

Targeted Consultation

Targeted consultation has been carried out with the following groups: the Commercial and Business Law committee of the New Zealand Law Society ("NZLS"), the New Zealand Institute of Chartered Accountants ("NZICA"), the Institute of Directors and Business New Zealand.

IMPLEMENTATION

The proposals will require legislative amendments to the Companies Act 1993 and the Limited Partnerships Act 2008.

Enforcement will be undertaken through the enhanced powers of the Registrar, and by modifying the application process to ensure that all new incorporation applicants are subjected to the new regime.

Publicity would be given to legislative changes by way of a communications programme which would be delivered through the usual Companies Office systems. This would include website content, communication through the Ministry of Economic Development Monthly Business Update publication, media releases, and short articles in professional publications such as the New Zealand Law Society magazine *Law Talk*.

MONITORING, EVALUATION AND REVIEW

Quarterly statistics on the number of requests from offshore enforcement agencies to the New Zealand police for assistance in investigations into New Zealand registered companies will be compared pre- and post- intervention in order to ascertain whether there has been a drop in the number of such companies involved in suspected criminal activity.

Monitoring of the effect of compliance costs will take place via the regular Companies Office surveys of its clients (which will include a specific question regarding the new processes), and via feedback through its website and contact centre. In addition, feedback from the business.govt website (which is a cross-governmental business information website) will be monitored.

Monthly, quarterly, and annual registrations will be compared pre- and post-intervention to ascertain whether the intervention has had a material impact on the overall number of business registrations. These data will be collected by the Companies Office as a matter of course, and are able to be analysed in this manner at minimal marginal cost to the Ministry.