



Do You Really Know Who is in Control?

Why Beneficial Ownership Transparency Matters

By Kate Jones Troy and Steve Rowland

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Introduction

Legal entity structures, including corporations, trusts, partnerships and others (collectively “Legal Entities”) have long been recognized in law as an effective means for individuals or groups of people to establish businesses and engage in lawful activities including for commercial, financial, philanthropic and estate planning purposes. Legal Entities may own property, execute contracts, pursue judicial action and survive their individual owners’ lifetimes. Legal Entities also facilitate financial privacy, widely recognized historically as a legitimate interest.

Legal Entity structures, however, may shield the identities of the individuals who form, own and/or control them. As such, Legal Entities also may be used to facilitate criminal activity including, among other things, tax evasion, fraud, money laundering, terrorism financing and sanctions violations.

Unlawful use of Legal Entities has been repeatedly highlighted over the last several years on both macro and micro levels including:

- Danske Bank as the central player in reputedly the largest known money laundering scandal by value identified to date, with current estimations topping \$230 billion laundered between 2007 and 2015
- The Panama Papers and the Paradise Papers’ leaks spawning investigations by governments around the world for tax evasion among other things
- A prosecution brought against four individuals related to the Panama Papers leak where the U.S. Attorney in Manhattan commented, “The defendants, employees and a client of global law firm Mossack Fonseca, allegedly shuffled millions of dollars through offshore accounts and created shell companies to hide fortunes.”¹
- A 2017 case where the United States FBI’s anti-corruption unit allegedly rented space from a Malaysian family, whose identity was well hidden behind legal entity structures, under investigation for corruption

Criminals’ abuse of Legal Entities to facilitate their activity and benefit from its profits has resulted in identifying beneficial owners of Legal Entities as a major area of focus for international financial regulators and law enforcement agencies.

Anti-money laundering (AML) and sanctions laws and regulations require financial institutions and other obliged entities, e.g., lawyers and accountants, (collectively Obligated Entities) to identify and verify the identity of their clients’ beneficial owners.

Failure to comply with applicable beneficial owner-related laws and regulations brings with it the risk of significant regulatory and law enforcement action, major fines and reputational harm. This paper summarizes key areas for consideration regarding beneficial owners. In particular, the paper:

- Compares varying regulatory approaches to identifying beneficial owners in key global financial centers
- Highlights challenges in identifying beneficial owners
- Highlights the importance of identifying beneficial owners to sanctions compliance
- Argues for enhancing international coordination in defining and means of identifying beneficial owners

¹ <https://www.justice.gov/usao-sdny/pr/four-defendants-charged-panama-papers-investigation>

Beneficial owners – varying legal and regulatory approaches

Recognizing the threat posed to the financial system by a lack of beneficial ownership transparency, beginning in 2003, FATF's Recommendation 33 and 34 set out that countries ensure adequate, accurate and timely information is available on the beneficial ownership and control of legal persons. Following FATF's revisions to its recommendations in 2012, the beneficial ownership recommendations are now numbered 24 and 25. FATF also recommended in its 2014 Guidance on Transparency and Beneficial Ownership that Legal Entities authorize at least one individual to hold this information and, crucially, to be accountable to the authorities for doing so. Intending that this obligation be taken seriously, FATF said at the same time that failure to comply with its recommendations should attract effective, proportionate and dissuasive sanctions.

Substantial challenge for Obligated Entities, however, results from the varying definition of beneficial owner in global laws and regulations and the lack of independent and reliable sources from which this information can be obtained. Beneficial owner definitions vary significantly and include those with a 25% or greater equity interest or voting rights, those who control a legal entity and/or those who benefit from a legal entity. A table containing examples of beneficial owner definitions is set out below; for ease of reference, the definitions in the table are summarized from the specified regulations.

European Union: 4 AMLD requires Legal Entities to obtain and hold "adequate, accurate and current information" on their beneficial owners. Beneficial owner information has to be accessible by authorities and held in central registries. As discussed more fully below, central registries are required to be open to persons with a "legitimate interest" in this information.

In July 2018, following the Paradise Papers leak, the EU issued its fifth AML Directive (5 AMLD)² strengthening its approach to beneficial owner transparency. 5 AMLD amended 4 AMLD by introducing "effective, proportionate and dissuasive measures or sanctions" for those failing to comply with beneficial owner requirements. In many circumstances, members of the general public would be able to see the Legal Entity information maintained in EU required central registries. A legitimate interest standard has, however, been maintained for trusts. The EU Member States' central registries are to be interconnected via the European Central Platform.

United Kingdom: The United Kingdom's approach centers on the voting rights of a Legal Entity with an individual holds more than 25% of the voting rights in a Legal Entity being considered beneficial owner even where the individual holds less than a 25% equity stake in the Legal Entity.

United States: The United States Customer Due Diligence (CDD) rule took effect in May 2018. The CDD rule, among other things, requires Obligated Entities to identify and verify the identity of beneficial owners.

The U.S. approach to the calculation of beneficial ownership focuses both on ownership and control of the Legal Entity. The ownership reporting threshold is set at 25% of equity interests and is independent of the control requirement. The U.S. definition of beneficial owner also required the identification and verification of a control person, "a single individual with significant responsibility to control, manage or direct a legal entity customer." Both individuals holding 25% of the equity shares of a Legal Entity customer and a single control person are considered beneficial owners. In some circumstances, there may be overlap between equity owners and a control person.

It is worth noting that similar proposed rules had been considered in the United States for many years prior to the CDD rule finally being passed in 2016. Prior proposals failed in the face of opposition from banks and members of the public related to the burden of obtaining and maintaining this information and the perceived invasion of privacy associated with it.

Hong Kong: Hong Kong's Anti-Money Laundering and Counter-Terrorist Financing Ordinance defines a beneficial owner as an individual who owns or controls more than 25% of: a corporation's share capital, a partnership's capital or profits, trust property capital, or is entitled to exercise or control more than 25% of the voting rights of these Legal Entities, or who exercises ultimate control over their management.

Singapore: In Singapore, Notice 626 requires banks to act with due diligence when dealing with customers and their beneficial owners. Notice 626 also requires banks to inquire whether or not there is a beneficial owner of their customers and, if so, to identify the beneficial owner(s) and to take reasonable measures, using reliable and independent sources, to verify beneficial owners' identity.

A table setting out a summary of beneficial owner definitions referenced above is included as Appendix A to this paper.

² <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32018L0843>

Central Beneficial Owners Registers

One means of facilitating the collection and retrieval of beneficial owner information is for state-mandated central beneficial owner registries to be established and maintained by government agencies.

European Union: The European Union required all member states to enact laws requiring the establishment of central beneficial owner registries by June 26, 2017, the transposition date for the EU's 4 AMLD. The EU also requires that these registries be interconnected. The value of the EU 5 AMLD-required central registries would be enhanced by mechanisms designed to ensure that their information is adequate, accurate and current.

France, Germany, the United Kingdom and other EU member states have established central registers. A number of EU member states, however, have not yet implemented central registers. For example, the Netherlands introduced a bill to create a central registry on April 4, 2019 and Ireland passed its legislation creating a central registry in April 2019. Ireland's registry is to come into operation on June 22, 2019.

United States: In the United States, the creation of a nationwide database of beneficial ownership was included in the Counter Terrorism and Illicit Finance Act (CTIFA) Bill. However, this provision was removed from the Bill when a revised draft went before Congress in June 2018³. This Bill was not approved by Congress and its successor, the Corporate Transparency Bill was introduced to Congress on May 3, 2019⁴. This revised Bill does not propose a central public register for beneficial ownership.

Hong Kong: The Companies (Amendment) (No. 2) Ordinance 2018 requires all companies incorporated in Hong Kong (with the exception of listed companies) to hold a register of their beneficial owners. These registers must be provided to the relevant regulators on demand.

Singapore: A similar requirement exists in Singapore. However, this is extended to foreign companies and limited liability partnerships⁵. Listed companies and limited liability partnerships that are Singapore financial institutions are exempt from this requirement.

The reliability and use of central beneficial owner registers will significantly depend on whether governments mandate beneficial owner information to be accurate when submitted and periodically updated. Their use will also depend on who is allowed to access the information stored in them – from government entities to Obligated Entities and others with a legitimate interest. Laws establishing central registers should consider criminal penalties for filing false information or failing to update information in required time frames. Also, the agencies overseeing central registers should be adequately resourced so that information submitted can be verified. Having a central point of verification would alleviate significant effort on behalf of both Obligated Entities and Legal Entity customers from complying with beneficial owner laws and regulations.

The experience of the United Kingdom highlights challenges in the effectiveness of these central registries. The UK introduced the Information about People with Significant Control (Amendment) Regulations 2017 (effective on June 26, 2017). The regulations require the creation of a central register which is to be held by the registrar of companies, known as Companies House. The information held in the register comes from the beneficial owners themselves. Those with something to hide could be expected to show little candor.

A study of the UK register by Global Witness⁶ identified a number of deficiencies, including a significant number of variations on the spelling of "British." It also found instances of people recording their nationality as "Cornish" (a term used to describe people from Cornwall, a county in the South West of England).

The reliability of information held by Companies House is challenged by the fact that Companies House is a registrar with no obligation to verify information submitted to it. In July 2018, Global Witness called for Companies House to be given the resources to do this verification. The need for this has never been greater. On April 11, 2019, the Council of Europe made pointed reference to the role played by corporate structures incorporated in the United Kingdom in recent money laundering scandals⁷.

³ <https://www.natlawreview.com/article/beneficial-ownership-provision-stripped-latest-draft-counter-terrorism-and-illicit>

⁴ <https://www.govtrack.us/congress/bills/116/hr2513/text/ih>

⁵ <https://www.acra.gov.sg/legislation/legislative-reform/companies-act-reform/companies-amendment-act-2017/register-of-registrable-controllers>

⁶ <https://www.globalwitness.org/en-gb/blog/10-lessons-uks-public-register-real-owners-companies/>

⁷ <http://assembly.coe.int/nw/xml/XRef/Xref-XML2HTML-en.asp?fileid=27674&lang=en>

Sanctions

The need to identify beneficial owners in order not to run afoul of financial crime laws and regulations is not limited to the AML context. Unwrapping beneficial owners is an expected component of compliance programs related to sanctions laws and regulations including those implemented by the U.N., EU, U.S. and others.

Sanctions typically target individuals, entities and market sectors, commonly referred to as sectoral sanctions, e.g., the energy, defense or financial industry of a country. One issue requiring attention is managing the impact of sanctions laws in the context of beneficial owners. For example, in 2014, the United States Office of Foreign Assets Control, OFAC, published revised guidance⁸ in which it stated that if 50% of a legal entity is owned in any way by an individual on its list of specially designated nationals, (SDN list), then the entity would itself be considered sanctioned.

In order to avoid breaching sanctions, potential customers and related parties must be screened against applicable sanctions lists. Third-party provided data-driven solutions facilitate compliance with these expectations.



⁸ https://www.treasury.gov/resource-center/sanctions/documents/licensing_guidance.pdf
https://www.treasury.gov/resource-center/faqs/sanctions/pages/faq_general.aspx#50_percent

Challenges for Obligated Entities

Obligated Entities face significant challenges in complying with beneficial owner and related sanctions laws and regulations including:

- Confirming the applicable legal requirements in the jurisdiction(s) a customer relationship is being established or maintained
- Where applicable, tracking new accounts vs. existing customer relationships in order to ensure beneficial owner information is obtained and updated for each new account, with limited exceptions to this expectation, e.g., those set out in the U.S. CDD rule
- Evaluating whether in certain circumstances unwrapping beneficial ownership to a lower threshold is warranted, e.g., when a customer has been identified as presenting increased risk of money laundering. FATF has included the below factors in its list of indicators of concealed beneficial ownership⁹ and indicated their presence, among other concerns, would point to the need for a beneficial ownership threshold lower than 25%
 - The customer or client – a client might show reluctance to provide details about beneficial ownership
 - The corporate vehicle used by the client – indicators of it being a shell company include the use of nominees as directors or shareholders
 - The transaction itself – the customer may, for example, be both the ordering and beneficiary customer, or connections between the parties may give rise to concerns
- Evaluating whether interests which are less than 25% baseline regulatory thresholds should be aggregated and individuals considered beneficial owners based on, e.g., family relationships when individually they would not meet stated reporting thresholds
- Managing beneficial owners identification in complex and multilayered ownership structures
- Managing beneficial owners and related sanctions risks when an individual beneficial owner may not be individually listed as sanctioned but an entity owned by that individual is or the reverse

Some relief has been given in certain laws and regulations which exclude specified customer types from the requirement to provide beneficial owner information. Examples of exclusions include listed and regulated entities. The EU 4 AMLD and laws in the UK, U.S., Singapore and Hong Kong exclude companies listed on certain exchanges or regulated by certain regulators from the need to disclose their beneficial ownership. These exclusions depend on the exchange or regulator with the concept of similar disclosure requirements. 4 AMLD requires the exchange to be subject to disclosure requirements that satisfy EU law. Similarly, the United States' CDD rule excludes customers who are regulated by U.S. federal functional regulators. Singapore requires that the external stock exchange be subject to enforceable requirements relating to transparency of beneficial ownership. Applying these exclusions is a detailed exercise.

Given the above considerations, there is a wide range in how Obligated Entities approach complying with beneficial owner-related laws and regulations. For example, in an exercise of caution, some Obligated Entities are unwrapping beneficial owners for listed entities specifically excluded by applicable laws. The wide range in compliance approaches is difficult for clients to manage and may impede timely access to financial services as an unintended consequence of these laws. Those complying only with the strict terms of laws may risk not meeting regulators' expectations on this front and risk censure as a result.

Resources available to assist Obligated Entities in complying with beneficial owner laws and regulations include third-party provided solutions. These solutions facilitate both the identification and screening of beneficial owners. The best of these solutions allows beneficial ownership to be unwrapped to different levels, depending on the assessed level of attendant risk. Third-party solutions powered by sufficiently comprehensive data also may allow hitherto hidden connections between beneficial owners to be identified. The speed with which third-party provided solutions operate is also of importance. A further quality of the third-party solutions on the market is the creation and retention of an audit trail. All of these key attributes facilitate Obligated Entities' ability to meet regulatory expectations.

⁹ <http://www.fatf-gafi.org/media/fatf/documents/reports/FATF-Egmont-Concealment-beneficial-ownership-annex-E.pdf>

Appendix A: Beneficial Owner Definition Comparison

Please note: Regulatory definitions referenced in Appendix A are summarized for ease of reference.

BENEFICIAL OWNERSHIP OVERVIEW							
FATF Recommendations		<ul style="list-style-type: none"> Companies and other legal persons should hold adequate, accurate and timely information on their beneficial ownership Companies should authorize at least one individual to hold the information and to be accountable to the authorities Failure to comply with these recommendations should attract effective, proportionate and dissuasive sanctions 					
Register Location		<ul style="list-style-type: none"> Customer-held register means a register held by the entity itself. This may not be publicly available and must be produced to the regulator on demand Central register means a register held by a public office (such as Companies House). This may be searched by members of the public 					
Jurisdiction	Risk Based Approach	UBO Definition	UBO/ Equity	UBO/ Voting Rights	25% Unwrap	Customer-Held Register	Central Register
United States	✓	Each individual who owns directly or indirectly 25% or more of equity interests in a legal entity (the ownership prong) AND a single individual who has significant responsibility to control, manage or direct that legal entity, including an executive officer or senior manager or any other individual who regularly performs similar functions (the control prong).	✓		✓		
European Union	✓	<p>Any natural person who ultimately owns/controls the customer, or for whom the transaction is conducted. For trusts, this includes settlors, trustees and beneficiaries.</p> <p>For Any corporate entities:</p> <ul style="list-style-type: none"> Ownership/control is indicated by ownership of more than 25% of shares, voting rights or ownership interest in the entity If no such person can be found after an exhaustive search, the senior management official – an officer or employee who is versed with entity's AML/CTF exposure and able to make decisions on this – is the beneficial owner 		✓	✓		✓
Hong Kong	✓	<p>Individual who:</p> <p>For a corporation:</p> <ul style="list-style-type: none"> Owns or controls, directly or indirectly, including through a trust or bearer share holding, more than 25% of the issued share capital of the corporation Is, directly or indirectly, entitled to exercise or control the exercise of more than 25% of the voting rights at general meetings of the corporation Exercises ultimate control over the management of the corporation <p>For a partnership:</p> <ul style="list-style-type: none"> Is entitled to or controls, directly or indirectly, more than a 25% share of the capital or profits of the partnership Is, directly or indirectly, entitled to exercise or control the exercise of more than 25% of the voting rights in the partnership Exercises ultimate control over the management of the partnership <p>For a trust:</p> <ul style="list-style-type: none"> Is entitled to a vested interest in more than 25% of the capital of the trust property The settlor, protector or enforcer of the trust An individual who has ultimate control over the trust <p>For any other legal entity:</p> <ul style="list-style-type: none"> An individual who ultimately owns or controls that entity <p>If any of the above entities are acting for another person, the beneficial owner is that person.</p>	✓	✓	✓	✓	
Singapore	✓	Natural person who ultimately owns or controls the customer, or the natural person on whose behalf a transaction is conducted or business relations are established and includes any person who exercises ultimate effective control over a legal person or legal arrangement.	✓		✓	✓	

Conclusion

While Legal Entity structures facilitate legitimate business, they also may provide hiding places for money launderers and other criminals' funds and other assets, including real estate. To impede criminals' ability to hide and ultimately use their criminally derived assets, global regulators require Obligated Entities to identify the beneficial owners of their Legal Entity customers. Complying with these laws and regulations is a complex exercise requiring sophisticated analysis of Legal Entity customer structures and applicable laws and regulations.

Given the variances in beneficial owner-related laws and regulations including the definition of a beneficial owner, the current lack of publicly available information for beneficial owners, the complex structures Legal Entities may create to engage in legitimate business, obtaining beneficial owner information will be an ongoing challenge for Obligated Entities. While central registries are now components of some countries' beneficial owner-related

laws and regulations, their utility is limited based on the lack of verification of the data submitted to them. Establishing and enforcing requirements for accurate filings will help render the registries more reliable and effective. Obligated Entities, however, will still need to identify which Legal Entity structures in an ownership chain beneficial owners are required for and obtain independent and reliable information for each of these entities to meet regulatory expectations.

Beneficial owner identification is a key to combating financial crime. Agreeing on a standard definition of beneficial owners and mandating beneficial owner registries, if executed and maintained in a way that addresses reliability and independence expectations, will help Obligated Entities execute regulatory expectations. Third-party provided solutions will facilitate Obligated Entities' and their customers' compliance with beneficial owner laws and regulations.

Authors

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