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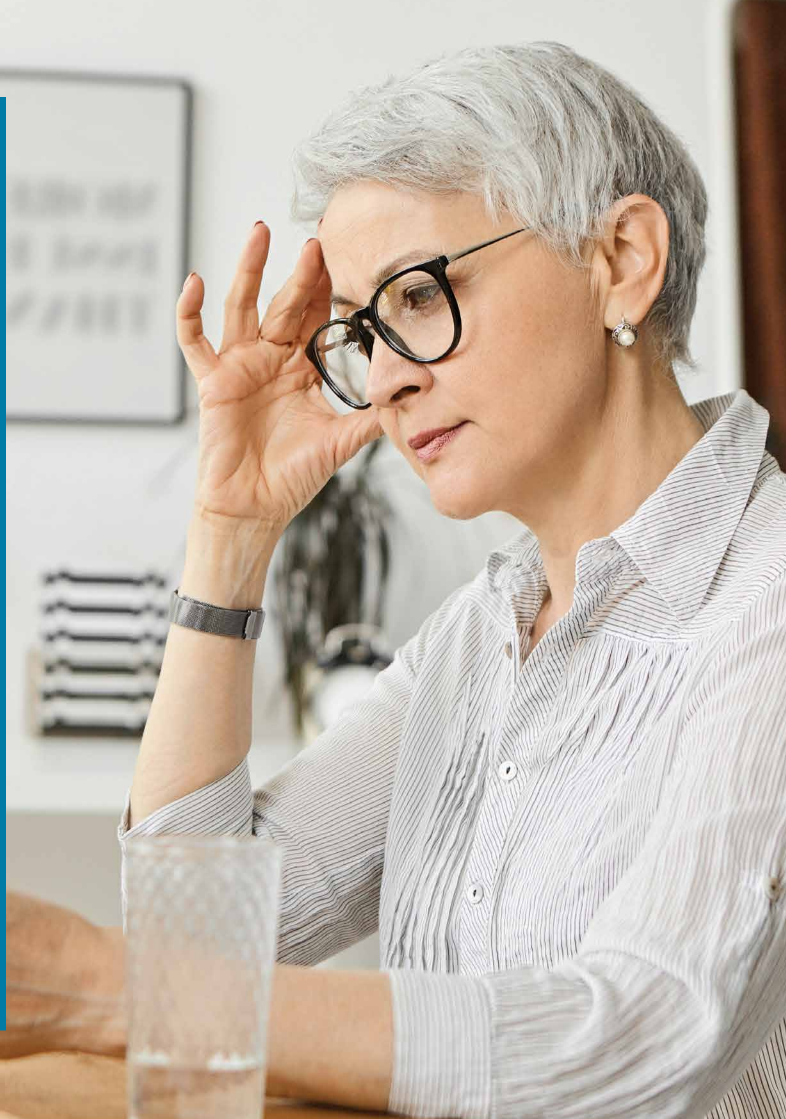
Hidden in plain sight: **Spotting signs of beneficial ownership**

Why beneficial ownership matters

At the most fundamental level, financial services firms, and indeed all companies operating internationally, need to have confidence that the third parties that they deal with are who they say they are. Not only does this assure compliance with the raft of national and international anti-money laundering (AML), anti-bribery and corruption (ABC) and know your customer (KYC) regulation, it protects reputations. And increasingly, that matters.

This is not, of course, just a question of knowing the legal entity, but rather having a clear sight of the ultimate beneficiary of the service. Failure to follow the trail is not just poor business practice; it exposes individuals and organizations to significant reputational, regulatory, financial and strategic risks.



Illuminating the shadowy world of offshore banking

The shockwaves first initiated with the publication of the Panama Papers four years ago continue to reverberate across the global financial community. The 11.5 million leaked documents revealed hundreds of thousands of shell companies set up by Panamanian law firm, Mossack Fonseca.[1] On investigation, a significant number were found to have been used for money laundering, bribery and tax evasion.

Since the 2016 revelations, heads of state and public officials have been implicated; $1.2 billion in global fines and back taxes have been recovered; and prosecutions and enforcement actions continue to this day.

While the majority of accounts set up by the now defunct law firm evidenced no illegal activity, the disclosures focused worldwide attention on the complexities of the banking system and the inherent lack of transparency in some corners of the sector.

In short, it highlighted the clear and present need to accurately identify ultimate beneficial ownership (UBO).

The evolving world of beneficial ownership requirements

According to the Financial Action Task Force (FATF), an inter-governmental body established in 1989 by the G7 major economies initiative, "Beneficial owner refers to the natural person(s) who ultimately owns or controls a customer and/or the natural person on whose behalf a transaction is being conducted. It also includes those persons who exercise ultimate effective control over a legal person or arrangement."[2]

While this is a helpful definition, there is no set global standard for how such guidance is applied in different geographies. In most countries, company shareholders are required to report their details to government or regulatory authorities. However, what actually constitutes a beneficial owner can vary—based on the number shares held, dividends taken, levels of influence within a company and so on.

Added to which, UBO can be something of a moving target. Regulations are rarely static and national and pan-national legislation is constantly evolving.

> Lava Jato in Brazil, the FIFA scandal and nearly every other major corruption case have involved opaque company structures created to bribe, receive bribes or to hide dirty money.[3]
>
> **Frederik Obermaier & Bastian Overmayer, Investigative Journalists**

6 Common challenges in uncovering beneficial ownership

Recently released guidance from FATF identifies six issues that must be addressed to better manage beneficial ownership risk.[4]

1. Failure to adequately assess the risk of beneficial ownership being used for illicit purposes

2. Reliance on inaccurate or out-of-date beneficial ownership information

3. Lack of universal database giving authorities have timely access to relevant beneficial ownership data

4. Insufficient transparency into bearer shares and nominee shareholder arrangements which could pose a risk of money laundering and terrorism

5. Lax legal penalties for companies that do not provide accurate information on beneficial owners

6. Inadequate tracking of the quality of cross-border support in identifying beneficial ownership

Timeline to transparency

1988
Bank for International Settlements creates the first international instrument to focus specifically on tackling money laundering.

1990
FATF proposes 40 recommendations to address misuse of corporate vehicles for criminal purposes and to combat the ability of criminals to disguise beneficial ownership.

2000
OECD is tasked with developing a set of initiatives to combat the abuse of beneficial ownership by the G7 countries.

2014
G20 leaders adopt ten high-level principles around beneficial ownership transparency, describing financial transparency as a “high priority” issue.

2015
World Bank aligns with the G20 approach, requiring greater beneficial ownership transparency.

2016
Panama Papers highlight ongoing beneficial ownership challenges.

2016
UK Enacts legislation requiring private companies to create a beneficial ownership registry.

2017
Countries begin to implement the EU 4th AML Directive requirement to establish centralized UBO registers.

2018
U.S. FinCEN Customer Due Diligence Final Rule takes effect, requiring identification of beneficial owners of legal entity customers.

2019
EU member states continue to introduce laws on UBO disclosures to meet EU 4th and 5th AML Directives.

The risks of uncertain ownership

The speed of change, alongside the lack of a standard global approach to UBO, is further complicated by the corresponding lack of wider company governance. Devices such as nominee shareholders or directors—where a third party is appointed as a director or shareholder but control still remains with the beneficial owner—are not illegal in many countries and are difficult to regulate.

Laws in some countries compel directors and shareholders to act in certain ways or face fines or being banned from directorships. However, in many offshore territories, nominee directors or shareholders can still be used as a vehicle to mask the identity of the beneficial owner. This is where it becomes difficult to identify where the buck ultimately stops.

There are also, of course, myriad laws governing company registrations and management in different geographic territories.

Banks and financial services are required to comply with a complex set of global regulations around transactions conducted for customers. This includes—as touched on previously—monitoring for anti-money laundering and anti-bribery and corruption. Financial institutions are required to carry out thorough onboarding checks for new customers and continue to carry out regular compliance checks, particularly for organizations they deem are at risk of AML or ABC breaches.

Institutions also need to scrutinize to those individuals that have a higher risk of corruption than the general population. These are typically people in positions of power or their immediate family. Politically Exposed Persons (PEPs) involved in companies or financial transactions must be carefully monitored.

The lack of clarity over who is the ultimate beneficial owner of a company or asset clouds the ability of banks and financial institutions to carry out these checks effectively. Many are left exposed to facilitating corruption, bribery or unwittingly funding illegal or terrorist activities. And quite apart from anything else, following extended trails can be a resource-intensive exercise at a time when the sector is striving to reduce overhead and improve and accelerate onboarding experiences.

Putting together a complete view of beneficial ownership

EXISTING INFORMATION

Use existing sources such as banks, property registries, tax authorities, stock exchanges and other public legal filings

REGISTRIES

Establish company registries to gather and maintain data on beneficial ownership

COMPANY REQUIREMENT

Require companies to collect and maintain up-to-date information on its shareholders

Mapping a changing landscape

Recent years have seen a steady increase in anti-money laundering, anti-bribery and corruption, and ultimate beneficial ownership regulation and enforcement.

UNITED STATES

In June 2019, the House Financial Services Committee approved new anti-money laundering legislation. If passed into law, the **‘Corporate Transparency Act’** will require small companies to disclose (for the first time) detailed information about beneficial owners.

This comes on the heels of the 2018 **Customer Due Diligence Requirements for Financial Institutions**. Issued by the Financial Crimes Enforcement Network (FinCEN), the Rule includes requirements that larger financial institutions **identify beneficial owners with 25 percent or more ownership** and conduct ongoing monitoring to identify suspicious transactions.

EUROPEAN UNION

In March 2019, the EU signed into law the **Anti-Money Laundering: Beneficial Ownership of Corporate Entities Regulations 2019**.

Complementing the above, the EU's **Fifth Money Laundering Directive (AMLD)** amends the 'reliable and independent source' requirement for verification of customer information to include 'where available, electronic identification means'.

It also adds a number of new measures, including:[5]

1. extending transparency obligations, including UBO, to all tax advisory services and Trusts;
2. possible reduction in beneficial ownership from 25% to 10% where an entity poses a significant money laundering or tax evasion risk;
3. enhanced due diligence when dealing with transactions from high-risk countries; and
4. obtaining evidence of the source of funds and source of wealth.

UNITED KINGDOM

With the UK looking to drive transparency at home and abroad, the Government is planning to establish a public register of beneficial ownership of overseas legal entities owning UK property. The bill is expected to become law in 2021. In a similar move, the UK's overseas territories will also have to make public the UBO of all registered companies—by the end of 2020.

In 2019, the first **Unexplained Wealth Order (UWO)** was obtained by the National Crime Agency to investigate London property assets linked to a politically exposed person believed to be involved in serious crime. The UWO (and supporting Interim Freezing Order) is a means of recovering the proceeds of corrupt activity where not possible through prosecution. Those failing to account for their wealth can now have UK assets seized.[6]

ASIA (HONG KONG)

With the aim of more closely aligning its AML laws with Financial Action Task Force (FATF) standards, the Hong Kong Government enacted two new laws in 2018:

- Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) (Amendment) 2018 (the ‘Ordinance’)
- Companies (Amendment) Ordinance (the ‘Companies Law’)

The ‘Ordinance’ law requires designated non-financial businesses and professions (lawyers, accountants, real estate agents, etc.) to apply customer due diligence and record-keeping requirements. Similarly, the ‘Companies Law’ requires companies incorporated in Hong Kong to maintain a register of beneficial ownership information of the company.[7]

Enforcement agencies show their teeth

When it comes to non-compliance, or if criminal activity is identified, the consequences are growing in severity. According to the *Global Bribery and Corruption Outlook 2019* published by Hogan Lovells, fines for bribery and corruption have continued to grow across the globe.[8]

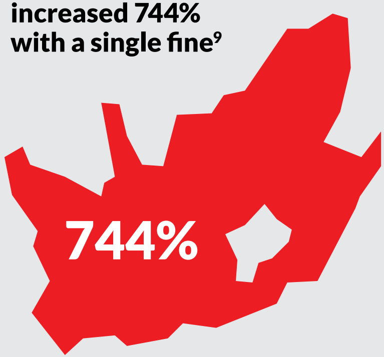
GET IT WRONG: GO TO JAIL

It is not just financial penalties that concern firms. More individuals are being prosecuted and receiving more jail-time for bribery and corruption than ever.

In the United States, sentences peaked in 2018, with an average of 65 months (including custody during investigations). In the first half of 2019, FCPA charges were brought against eleven individuals as part of the DOJ's much-heralded commitment to prioritizing prosecutions.[10]

U.S. fines grew 80% from 2017 to 2018 to $6.5 billion

South Africa fines increased 744% with a single fine[9]



Conclusion

Despite the complexities of tracking and uncovering ultimate beneficial ownership, it is essential to protect the integrity of the global financial services industry. Without beneficial ownership information, the risks of money laundering and tax evasion increase rapidly.

There is little doubt that governments and regulators across the world are committed to driving ever greater levels of transparency and are actively fine tuning their approaches to tackle money laundering, bribery and corruption.

This constant evolution of regulations—many of which differ between nations—poses significant challenges for businesses in the financial services market, which is increasingly becoming a global and real-time operation. The challenge is not only in navigating an evolving global regulation landscape but also developing the real-world operational processes to comply with them.

Endnotes

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[9] “FCPA Enforcement and Anti-Corruption Developments: 2019 Mid-Year Review,” PaulWeiss.com. July 18, 2019. Accessed at: http://bit.ly/337iu6k

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