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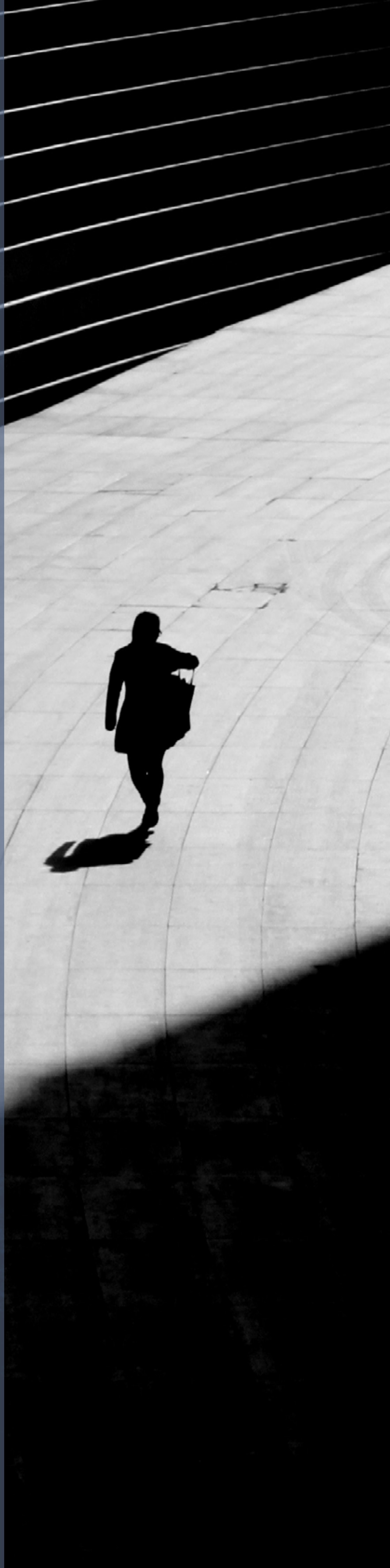
EBOOK

ultimate **beneficial ownership**

understanding **corporate hierarchy** and **criminal company ownership**, and the role it plays in laundering illicit funds



REGULATIONS INCREASINGLY STRINGENT ON IDENTIFICATION AND VERIFICATION OF BENEFICIAL OWNERS

Because companies drive much of the world's economic activity, individuals with criminal intent use companies as vehicles for money laundering by attempting to make unlawful transactions appear as legitimate business.

The criminal and the corrupt seek to hide their ownership of companies so they cannot be identified as the individuals who ultimately profit from prohibited activity. As evidenced by the Panama Papers, when ownership is hidden leaks generate broad interest and unleash reputational damage. Theresa May observes that hiding ownership information to launder money has deeply corrosive consequences "The laundering of proceeds of crime through UK institutions is not only a financial crime, it fuels political instability around the world, supports terrorists and extremism and poses a direct and immediate threat to our domestic security... we will not tolerate this type of activity in our financial institutions".

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> THERESA MAY
> UK PRIME MINISTER

Looking for chinks within a nation's money laundering defences, criminals extend their activities beyond financial institutions and will attempt to deceive legal and accounting firms in their attempts to infiltrate legitimate economies. As Paul Philip, Chief Executive of the Solicitors Regulation Authority observes "The credibility of law firms makes them an obvious target for criminals wishing to launder money. Tackling it is crucial not only to maintain trust in the profession, but also for the good of society".

Recognising that good governance is founded on corporate transparency, governments around the world are creating increasingly stringent regulations which require compliance from both parties to any business transaction. Companies are obliged to document and maintain information on the identity of their beneficial owners within registers that are either made public or accessible to those with legitimate interest.

On the counterparty side, money laundering regulations such as the UK's MLR2017 require that regulated firms providing financial and professional services must identify their customers' beneficial owners and take reasonable measures to verify their identities.

Know your customer (KYC) regulations that enforce corporate transparency by identifying beneficial owners reduce the risk of corruption and the cost of compliance, and firms undertaking appropriate due diligence guard their reputations against damage.

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> PAUL PHILIP
> CHIEF EXECUTIVE, SRA

THE MEANING OF BENEFICIAL OWNER

The Financial Action Task Force, that currently comprises 35 member jurisdictions and two regional organisations representing most major financial centres in all parts of the globe, advises that "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".

FATF clarifies that "ultimately owns or controls" and "ultimate effective control" refer to situations in which ownership/control is exercised through a chain of ownership or by means of control other than direct control.

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>
> FINANCIAL ACTION TASK FORCE

MLR 2017 states:

Where the customer is beneficially owned by another person, the relevant person must

(a) identify the beneficial owner;

(b) take reasonable measures to verify the identity of the beneficial owner so that the relevant person is satisfied that it knows who the beneficial owner is; and

(c) if the beneficial owner is a legal person, trust, company, foundation or similar legal arrangement take reasonable measures to understand the ownership and control structure of that legal person, trust, company, foundation or legal arrangement.

EVOLVING REGULATION TO GUARD AGAINST A SHIFTING THREAT

FATF laid the foundation for a globally consistent approach to identifying and verifying companies' beneficial owners with the 2014 publication of non-binding guidance on Transparency and Beneficial Ownership. While not specifying a threshold, this guidance introduced an example of "any persons owning more than a certain percentage of the company, such as 25%". Building on this momentum, the Fourth EU Anti-Money Laundering Directive (4MLD) came into force in 2015 and obliged member countries to implement national laws by June 26, 2017.

Many national jurisdictions across Europe and Asia - including UK, Denmark, Germany, France, Holland, Hong Kong, Norway, Singapore and many others - have followed this lead to establish a common threshold of ownership of 25% or higher as representing beneficial ownership. In the US, the Federal Reserve Board of Governors and Treasury's Financial Crimes Enforcement Network (FinCEN) new Customer Due Diligence rule which comes into effect in May 2018 establishes an ownership threshold of 25%. Australia's first Open Government National Action Plan 2016-18 commits to improve transparency of information on beneficial ownership and control of companies available to relevant authorities.

PROGRESS IN THE UK ON ACCESS TO OWNERSHIP INFORMATION

Following its commitment to open government, the UK - where a beneficial owner may also be referred to as a person with significant control - launched its PSC register in 2017 and made this open to the public. UK Companies, Societates Europaeae (SEs) and limited liability partnerships (LLPs) are required to identify and record the people who own or control their company. This information must be recorded within the company's own PSC register and forwarded to Companies House who publish it with open access. When beneficial owners change, a company must update the information on its own PSC register within 14 days, and update the information at Companies House within a further 14 days. Failing to record accurate information on the PSC register and failing to comply with notices to provide information are criminal offences, and may result in a fine and a prison sentence of up to two years.

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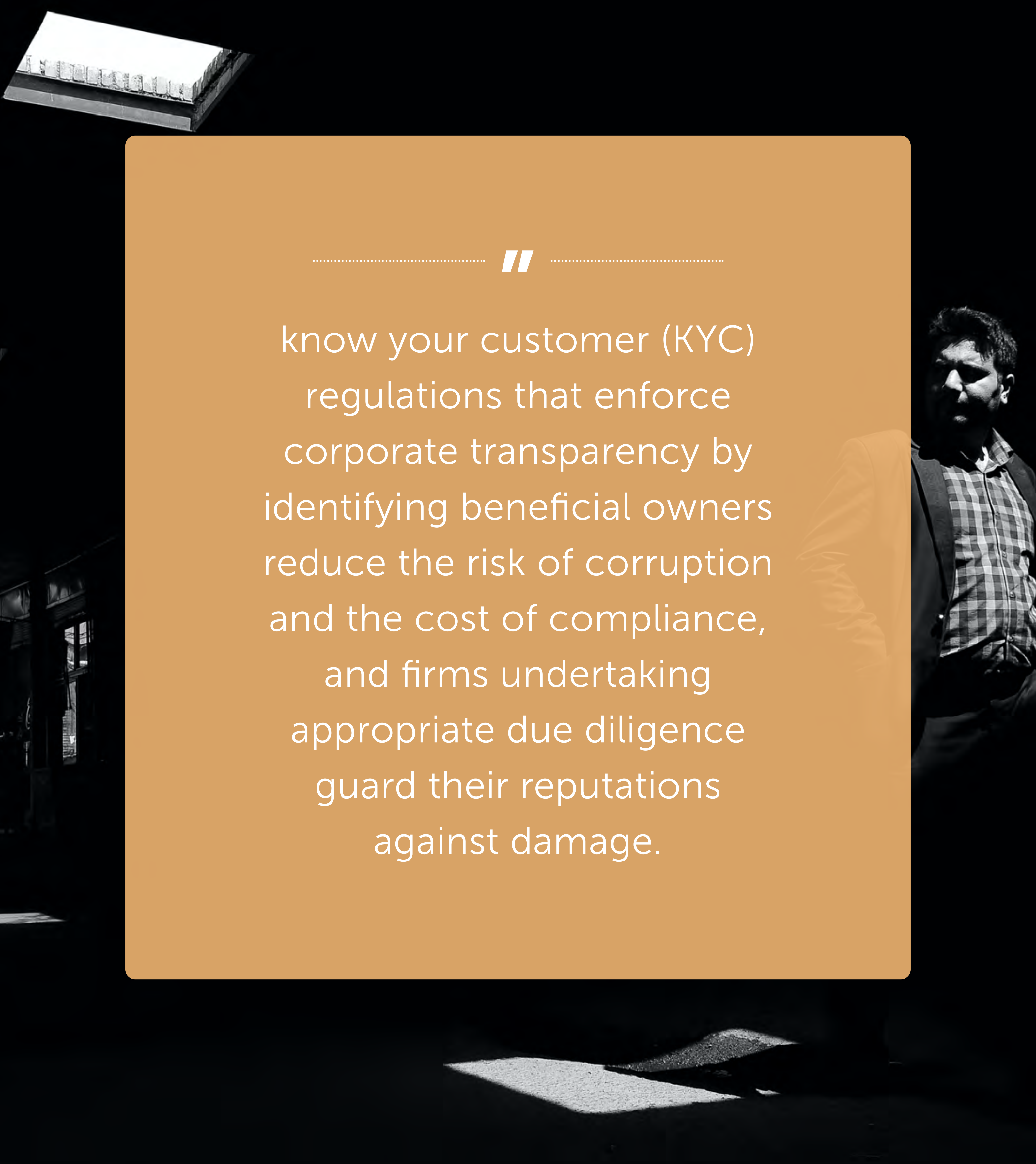
> ANDREW GRIFFITHS
> UK BUSINESS MINISTER

In File on 4, a BBC Radio current affairs programme transmitted on 6 February 2018, reporter Tim Whewell states of the PSC Register "Companies House, which registers all British firms, told us they systematically check the information they get, to make sure it's compliant". In the same broadcast, Murray Worthy, a senior campaigner from Global Witness - a non governmental, not for profit organisation that works to expose the shadow systems that enable corruption and conflict - reported the organisation downloaded the new PSC information to analyse ownership of UK companies and found that nearly one in ten companies - 350,000 companies - haven't declared who owns or controls them.

In March 2018 Companies House signalled the UK Government's intent to maintain truthful registers with the prosecution of a company director who has been fined for deliberately falsifying information about his firms. Business Minister Andrew Griffiths said "This prosecution – the first of its kind in the UK – shows the Government will come down hard on people who knowingly break the law and file false information on the company register. Companies House works hard to protect and continually upgrade the company register, identifying potentially criminal activities and working closely with law enforcement bodies to help bring those perpetrators to justice".

The Government's commitment to publicly accessible registers is not supported across both Houses of Parliament. In January 2018 the House of Lords rejected a proposal that six of the UK's overseas territories, - Anguilla, Bermuda, British Virgin Islands, Cayman Islands, Montserrat, and Turks and Caicos Islands - should create publicly accessible registers. British Virgin Islands registered thousands of companies revealed in the leaked Panama Papers.

MLR2017 states "Customer due diligence measures means identifying the customer and verifying the customer's identity on the basis of documents, data or information obtained from a reliable and independent source". To validate and verify ownership, compliance professionals have access to a broad array of reliable and independent sources, including government registers, freely reusable databases such as OpenCorporates and information available on subscription from companies specialising in maintaining databases of corporate ownership.



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GLOBAL PROGRESS ON CORPORATE OWNERSHIP TRANSPARENCY

Disclosure of Beneficial Ownership in Selected Countries, a report published in July 2017 by the Law Library of Congress (USA), provides an overview of national and state registers.

- All EU countries have either established or are establishing registers of beneficial ownership. Denmark, Finland, Latvia, Lithuania, Netherlands, Poland, Slovakia, and Slovenia have open registers, while many European countries limit access to those deemed to have legitimate interest, and in Portugal and Sweden you must be a national citizen to access registers.

- In Asia, Singapore has updated its Companies Act and implemented a public Register of Controllers that applies to limited liability partnerships and Singapore registered foreign companies. Hong Kong requires that organisations operating with its Companies Ordinance maintain a Significant Controllers Register to be made accessible to law enforcement officers performing functions relating to the prevention, detection or investigation of money laundering or terrorist financing. Japan does not have a national register, instead local bureaus which report to the Ministry of Justice collect some information, but this is not verified by government.

- In USA, state regulations apply to registration and publication of beneficial ownership and this information is not subject to Federal verification. Companies must update registers within 60 days of any change in beneficial owners. Canada currently does not have a register of beneficial owners, but its government is currently reviewing its Anti-Money Laundering and Anti-Terrorist Financing Regime with submissions to close at the end of April 2018.

According to the assessment of the Law Library of Congress, national governments committed to verifying information on ownership registers include Argentina, France, Mexico, Namibia, and Spain.

Registers of beneficial ownership are building blocks to transparency and good corporate governance. Making firms responsible for providing information about their beneficial owners creates a prime source of information that can be used by firms operating in financial and professional services and obliged by regulators to undertake customer due diligence to protect national economies from financial crime.

OPERATIONAL CHALLENGES OF KYC TO IDENTIFY BENEFICIAL OWNERSHIP

While regulations and ownership registers establish a framework for promoting corporate transparency, many firms operating in regulated industries struggle to implement KYC processes to capture information required to fulfil their obligation to identify and verify identity of beneficial owners.

A typical situation within compliance operations is for a KYC analyst to communicate with a client requesting details of structure and ownership and there follows a series of requests and responses as information is delivered in a piecemeal fashion. The analyst then faces the task of making sense of the structure, possibly by creating charts that map the different levels and the natural persons involved at each level, and then committing this understanding to a database. This can be especially difficult when working with multinational clients who often must be contacted for information on multiple occasions, and then who must go to holding companies and parent companies to ask for this information.

Teasing apart complex, multi-level, multi-national corporate structures can be a time-consuming and expensive task demanding great attention to detail and domain knowledge of corporate structures adopted by those intent on concealment. Many firms rely on processes that are either manual or a combination of manual and electronic tasks and while this approach can be effective, it is expensive, slow and complicates the work of compliance professionals.

BEST PRACTICE IN IDENTIFYING AND VERIFYING BENEFICIAL OWNERS

In the UK, the Joint Money Laundering Steering Group - made up of the leading UK Trade Associations in the Financial Services Industry - recommends that KYC analysts trace through corporate structures until they find a natural person, or the ownership dilutes to levels where no single person can assert control, or they reach a regulated company, or listed company, or subsidiary of a listed company, or a government entity which your firm's compliance policies assess as low risk.

BENEFITS OF DIGITISING KYC PROCESSES

Registers and other information sources used to identify beneficial owners are available as streams of digitised data, and this creates opportunities to automate KYC processes.

Using a data-driven approach an analyst drives investigation by entering a firm's name and then software interrogates registries in real-time, navigates through complex corporate structures, retrieves information identifying beneficial owners, shareholders, and directors, resolves multiple instances of each entity, and presents a unified view of beneficial ownership information in a chart that is interactive and easily understood. The same technology will periodically refresh risk assessments and detect changes in corporate structures, directors and beneficial owners. The ongoing monitoring of Politically Exposed Persons required by Enhanced Due Diligence is automated by software capable of constantly scanning news sources and sanctions lists.

Technology strengthens a firm's financial crime defences, reduces the burden of compliance work, simplifies the task of maintaining operational KYC processes to comply with changing regulations and ensures that a firm's operational practise remains consistent with its compliance policies. Technology reduces costs by increasing operational efficiency.

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Wayne co-founded **Encompass** in Sydney and took the product to the Australian market in 2012. Since then, as CEO he has led the international expansion of the company, including the UK launch in 2015 and recognition as one of the UK's most influential RegTech firms.

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