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REGULATION

Understanding beneficial ownership disclosure

PAUL M. GILMOUR

CRISIS MANAGEMENT

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DEAR READER,

Recent events in the U.S. banking sector, and broader concerns around instability and contagion within the global financial services industry, have meant that crisis management is once more front of mind for many institutions.

In addition, the world of business and finance is facing broader geopolitical and socioeconomic challenges, ranging from conflict, climate change, inflationary pressures, and precarious energy resources. Factor in heightened regulatory and competitive pressures, and it becomes clear that financial institutions must prioritize risk management, within their own organizations and with their counterparties.

The papers in this edition of the Journal address the theme of crisis management through various lenses, including regulatory compliance and traditional risk management, as well ESG, the low carbon economy, and sustainable finance. Our authors also explore topics such as the impact of social change on the world of finance, the rise of artificial intelligence and virtual reality technologies, and cybersecurity.

Contributions in this edition come from a range of world-class experts across industry and academia, and showcase some of the very best expertise, independent thinking, and strategic insights within the financial services sector.

As ever, I hope that you find the latest edition of the Capco Journal to be engaging and informative. Thank you to all our contributors, and thank you for reading.

Lance Levy, **Capco CEO**

UNDERSTANDING BENEFICIAL OWNERSHIP DISCLOSURE

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ABSTRACT

Beneficial ownership disclosure remains a contentious issue for government regulators, the financial sector, and business professionals. Corporate transparency campaigners and other advocates argue that the proper disclosure of beneficial ownership is crucial to maintaining a fair and strong global financial system. It enhances the transparency of tax affairs and other corporate dealings, and prevents illicit activities, such as money laundering and tax evasion. However, enhanced beneficial ownership transparency relies on an effective system involving accurate company disclosure of beneficial ownership, robust verification procedures, and ongoing monitoring. The process of identifying the real beneficial owner of company assets can also prove onerous and costly for those obligated to carry out proper customer due diligence under anti-money laundering rules. This paper provides an insight into the global efforts to enhance corporate transparency through the disclosure of beneficial ownership. It explores the role of company registers, examines the process of customer due diligence, and considers what the proper disclosure of beneficial ownership means for the regulated financial sector and the business community.

1. INTRODUCTION: WHAT IS BENEFICIAL OWNERSHIP?

The beneficial owner is the natural person(s) who ultimately owns or controls a legal entity or arrangement (such as a company or trust arrangement) on whose behalf a transaction or activity is being conducted [FATF (2014)]. It is the individual who stands to benefit or enjoy an asset – not necessarily the same person listed as the legal or official owner of the asset [Thorpe (2021)]. Consequently, beneficial ownership recognizes the fundamental separation of the legal and rightful owner of assets or other property. As a concept historically derived from trust law, beneficial ownership determines the equitable interest in property through the principle of equity, a remedial measure that seeks to overcome injustice caused by the strict application of common law rules. Beneficial ownership underpins many competitive markets, legitimate corporate dealings, commercial transactions, and uses; for example, trust arrangements, shell companies, company mergers and acquisitions, etc. [Gillis (2019)].

The term "beneficial owner" also features in the OECD's Model Tax Convention (on income and on capital), originally published in 1977 [da Silva (2017)]. This convention provides tax advice for countries engaged in bilateral negotiations with the aim of preventing businesses paying tax again on the same source of earned income when trading across jurisdictions [a principle known as double taxation; OECD (2016)]. The Model Tax Convention emphasizes that the person who has the "right to use and enjoy" passive income (meaning dividends, interests, or royalties) is considered the beneficial owner. It also notes that the beneficial owner is not compelled by law or through contract to pass that income onto another person [da Silva (2017)]. The inclusion of the phrase "beneficial owner" was intended to offer clarity to the notion of beneficial ownership and was done against the background of the Model Tax Convention's aim of preventing double taxation, tax avoidance, and evasion [Elliffe (2009), IBFD (2011)].

In the case of commercial entities, many jurisdictions stipulate beneficial ownership via a percentage threshold in which to quantify the benefit attributable to a real person behind a corporation. For example, the U.K. defines a beneficial owner

as those holding more than 25 percent of shares or voting rights in a legal entity [Subashi (2014)]. The U.S. Treasury Department's Financial Crimes Enforcement Network (FinCEN) Final Rule also applies this percentage threshold. However, in Bangladesh and Pakistan, the threshold is 10 percent, and as low as 5 percent in the Philippines [OECD (2016)]. Exceeding these thresholds requires a person to be disclosed as a company's beneficial owner on a centrally held register [Hook (2018)]. An exception to this rule is Mongolia, where no such disclosure threshold exists; beneficial ownership disclosure is only demanded for entities licensed to provide custodian services, and only as and when their circumstances change [OECD (2016). Beneficial ownership transparency is intended to prevent companies' owners from operating in secrecy and has become an important policy tool for governments in the fight against crime.

2. WHY DISCLOSE BENEFICIAL OWNERSHIP?

2.1. Beneficial ownership transparency

Many would argue that beneficial ownership transparency is vital to preventing money laundering, tax evasion, and other criminal activities. It helps to uncover corrupt wealth, aiding the authorities to identify, evidence, and recover stolen assets [Gilmour (2020, 2022a), Radon and Achuthan (2017)]. Recent exposés surrounding corporate transparency have increased pressure on governments globally to clamp down on immoral and criminal activities that abuse the financial system and undermine public trust in fair democracies.

In recent years, public scrutiny surrounding the transparency of corporates and their offshore business dealings has intensified due to successive high-profile data leaks [Radon and Achuthan (2017)]. In 2016, over 11 million leaked documents from Panama-based law firm, Mossack Fonseca, uncovered the widespread abuse of the financial system, which involved individuals concealing company beneficial ownership. This exposé became known as the "Panama Papers" and was followed by a similar leak known as the "Paradise Papers" a year later, which involved Bermudan law firm, Appleby [Gilmour (2020)]. Global transparency campaigners have justifiably been critical of strong tax avoidance schemes that benefit large multinational companies, the wealthy, or political elite.

Recent discourse has also emphasized the associated role of offshore jurisdictions in facilitating shady business dealings and illicit activities, like corruption and money laundering [Gilmour (2020), Thomas-James (2022)]. The "Pandora Papers" leaks of 2021 served to reaffirm public concerns around secretive offshore practices. An offshore financial center (OFC) is stereotypically viewed as a remote and idyllic small tropical island and developing microstate in the Caribbean. Yet, a significant number of jurisdictions within, or linked to, more developed Western economies have also appeared in the transparency spotlight. For instance, major financial hubs, like Singapore, Switzerland, U.K., Hong Kong, and the U.S. have, to varying extents, often supported fiscal policies based on stricter secrecy laws or client-confidentiality rules, favorable custom arrangements, and free trade zones with lower taxation in order to attract overseas investment [Young (2013), Thomas-James (2021)]. Indeed, much overseas wealth that is tied up within the U.K.'s property market has originated because of secrecy in beneficial ownership. Concerns surrounding the source of suspicious wealth in the U.K.'s property market has even led some to declare the City of London as "The money laundering capital of the world," [Raphael (2016), Transparency International UK (2017)]. Consequently, understanding the particulars of offshore finance has become key to governments' beneficial ownership transparency agendas.

As a result, many governments have committed to international standards on enhanced corporate transparency centered on the disclosure of beneficial owners [Cruz (2020)]. This has led to stronger anti-money laundering (AML) frameworks and customer due diligence procedures to curb money laundering and tax evasion, and to ensure they are seen by the wider AML community to be complying with relevant AML recommendations set by the Financial Action Task Force (FATF). The disclosure of beneficial ownership allows for a more transparent, accountable, and fairer financial system. It results in a more competitive business environment and improved investor confidence in financial markets [Cruz (2020), Vermeulen (2013)]. Transparency of beneficial ownership is also needed to ensure the automatic exchange of information on beneficial owners and so intergovernmental cooperative efforts can operate effectively [Konovalova et al. (2022)]. The next section discusses the risks associated with beneficial ownership obscurity.

2.2. Risks associated with a lack of beneficial ownership transparency

The risks associated with obscured beneficial ownership are diverse. Obscurity in beneficial ownership acts to undermine the political, legal, and financial systems and upsets social order [Niyetullayev and Almond (2014)]. Individuals can conceal beneficial ownership in various ways [Gilmour (2020, 2022a), Radon and Achuthan (2017), Thomas-James (2021), van der Does de Willebois et al. (2011)]. One example is through anonymous shell companies. Shell companies are

legal entities that ostensibly function through a registered address but generate little or no inherent value. It is important to note that beneficial ownership is hidden for legitimate commercial reasons. Anonymous shell companies are used to legitimately hold corporate stock, support company mergers, and enable the transfer of finance across jurisdictions. However, anonymous shell companies have become useful vehicles for facilitating illicit activities through obscuring beneficial ownership [Konovalova et al. (2022)]. Shell companies can also be registered anonymously, at low cost, and with little oversight from regulators.

Furthermore, criminals can layer company ownership using nominee shareholders and professional intermediaries (for instance, lawyers, accountants, and trust and company service providers) and through multiple corporations registered in offshore jurisdictions [Bieler (2022)]. Many legal entities, intermediaries, and people can operate in different ways across multiple levels within the broader corporate structure to affect how each entity within is controlled in determining the ultimate beneficial owner [FATF (2018)]. Elaborate arrangements like these make identifying the beneficial owner difficult for authorities. Criminals seek to exploit corporate beneficial ownership to distance the registered or legal owner of illicit assets from the source of criminality and ultimately obscure the real beneficiary of criminal proceeds [Gillis (2019), Pacini and Wadlinger (2018)]. Figure 1 represents the complexity of corporate structures and demonstrates how elaborate corporate structures can obscure the beneficial owner of assets.

As illustrated in Figure 1, suppose corporate entities registered in various jurisdictions are controlled by several people, each having a different role in the entities' control. Assets are held in a bank account located in one country, despite the account holder being in the name of Company A, registered in another jurisdiction. Company B holds shares in Company A, yet the legal owner of Company A is Company C, located elsewhere. A professional intermediary acting as trustee for Company C is used to incorporate Company C and Company E on behalf of another, based in another offshore jurisdiction. A person located in another country physically holds the bearer share certificate relating to Company D, which manages Company B. This person also acts as settlor in dividing assets of Company E to a trustee and acts as the legal owner of Company F, which is registered overseas. Yet, the layering of beneficial ownership through complex corporate structures also means that individuals can simply circumvent any legal disclosure requirement by ensuring no one person holds more shares or interest in any one company than the disclosure threshold defined by national laws (Figure 2).

Layering company ownership helps to conceal the real beneficial owner of criminal assets. Existing disclosure thresholds determine whether a person is required to be disclosed as a company's beneficial owner (for example, more

Figure 1: The complexity of corporate structures

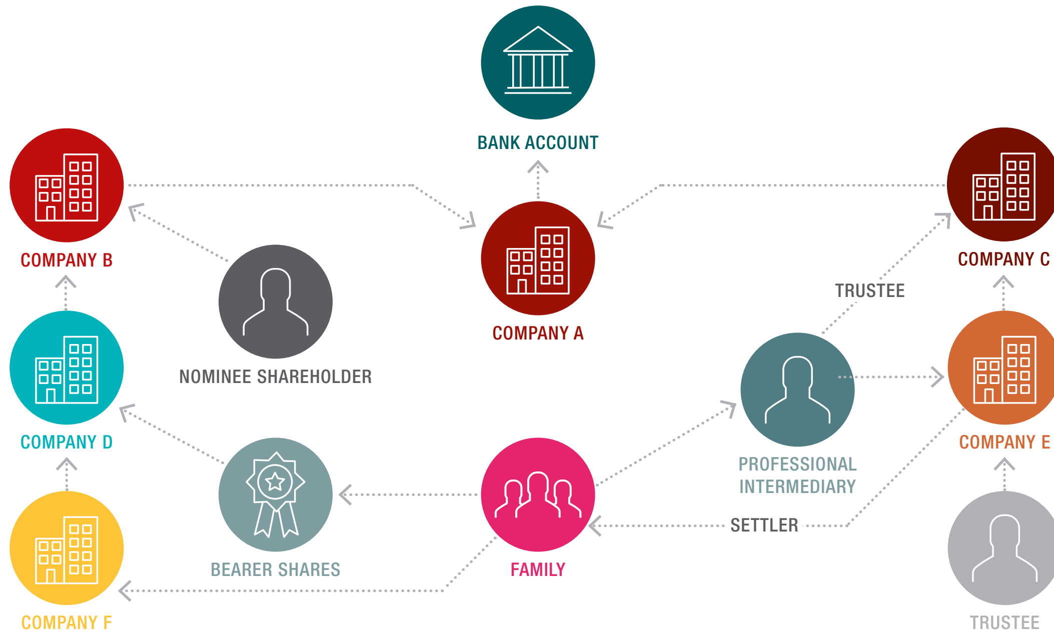
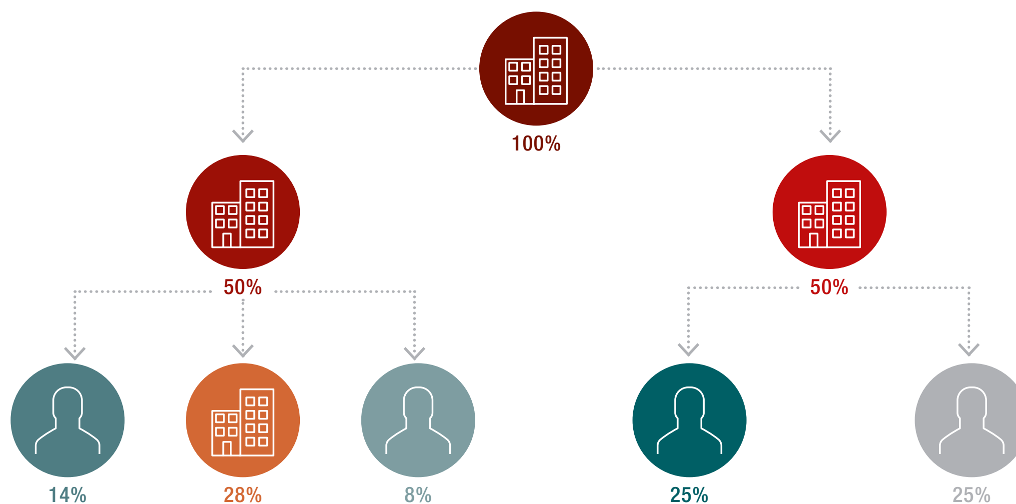


Figure 2: Layering company ownership



than 25 percent of shares or voting rights in a legal entity, as is the case in the U.K.). However, these thresholds could be viewed as meaningless. For example, the U.K.'s threshold can be circumvented by structuring company ownership to ensure no person holds more than 25 percent of shares or voting rights in a company. Otherwise, a company formation agent might be listed as a legal owner. Yet, despite corporate structures often being complex as illustrated by these examples, there is always a natural person behind the various companies involved [Riccardi (2013)].

2.3. PEPs and other high-risk entities

Further risks associated with beneficial ownership obscurity center on the role of politically exposed persons (PEPs) and other high-risk entities. PEPs are individuals that may be more susceptible to corruption due to their public profile, status, or influence in government, the judiciary, or other state or corporate functions. According to FATF (2013) guidelines, they include several high-ranking and powerful roles – and their relations and associates – for example, politicians, supreme court officials, senior military, state ambassadors, and high-profile international company directors. Notably, they do not include middle- or lower-ranked officials [Menz (2021), Suntura et al. (2021)], though there are some inconsistencies in how PEPs are defined with various interpretations across international AML and financial sector bodies [Menz (2021)]. Furthermore, the U.K.'s Criminal Finances Act 2017 deems a PEP to also encompass anyone otherwise connected with someone who is already defined as a PEP – and would include a vast array of individuals involved in doing business with a PEP or merely associating with them. Such a wide scope underlines the recognition of the potential money-laundering and corruption risks that PEPs present [Menz (2021)].

PEPs and corporate entities associated with states having insecure or undemocratic governments can also present higher money-laundering and corruption risks. High-risk countries may feature on the FATF's published "grey list", which represents those countries having strategic deficiencies in their regimes to counter money laundering, terrorist financing, and proliferation and are, therefore, subject to increased monitoring [FATF (2022)]. Such countries work with the FATF to resolve shortcomings in their regimes within a set timeframe or risk being placed on the more punitive "blacklist". The blacklist includes countries considered uncooperative when dealing with authorities seeking to investigate money laundering or failing to comply with AML guidance. Blacklisting aims to "name and shame" and stigmatize countries featured on the list, and any country or organization associated with them; therefore, placing them under international pressure to cooperate with AML regimes. Failure to do so can cause financial costs and reputational damage to those involved [Gilmour (2020)]. Only North Korea and Iran currently feature on FATF's blacklist, whereas over twenty nations appear on the grey list and are subject to periodic change depending on ongoing in-country mutual evaluations of their AML and countering terrorism financing frameworks and procedures [FATF (2022)]. The next section discusses what the disclosure of beneficial ownership means in practice.

3. REGISTERS OF BENEFICIAL OWNERS

Many countries have established some form of beneficial ownership register or are in the process of doing so, but beyond the U.K. and some E.U. member states, fully public registers are not universally implemented. The E.U. has largely adhered to FATF's Recommendations 24 and 25 concerning the transparency and beneficial ownership of legal persons, and legal arrangements respectively, which advocate for nations to establish registers of beneficial owners. The E.U.'s 4th Anti-Money Laundering Directive [Council Directive (2015/849EU)][1] required E.U. member states to introduce their own national registers of beneficial owners. Notably, Article 30(5) of 4AMLD stated that information held on such a register must be made accessible in all cases to:

a. competent authorities and [financial intelligence units], without any restriction,
b. obliged entities, within the framework of customer due diligence […],
c. any person or organization that can demonstrate a legitimate interest.

Importantly, point c) of Article 30(5) was subsequently amended via the 5th Anti-Money Laundering Directive (Council Directive 2018/843EU) to: "any member of the general public … [is] permitted to access at least the name, the month and year of birth and the country of residence and nationality of the beneficial owner as well as the nature and extent of the beneficial interest held" [Council Directive (2018/843EU)].[2]

However, 2022's landmark ruling by the Court of Justice of the European Union (CJEU) confirmed that fully public registers on beneficial ownership within the E.U. conflict with the fundamental rights to privacy and represents a setback for transparency advocates. The CJEU considered a joint case brought against the Luxembourg Business Registers by two companies trying to restrict access to information held on their beneficial owners. The Court ruled that access to beneficial ownership information was "neither limited to what is strictly necessary nor proportionate to the objective pursued" and that allowing full access to the "general public" to information on beneficial owners interfered with the rights guaranteed in Articles 7 and 8 of the Charter of Fundamental Rights of the European Union (WM and Sovim SA v. Luxembourg Business Registers).[3] This ruling, in essence, invalidated the provision under Article 30(5) as amended by the 5AMLD that guaranteed full transparency of beneficial ownership.

Nonetheless, E.U. member states are still offered discretion as to how national registers are implemented domestically. For example, the U.K. established a fully public "persons of significant control" (PSC) register prior to leaving E.U. membership. The PSC register is held by the U.K.'s executive agency and registrar of companies, Companies House. Beneficial ownership information is freely available except in circumstances that might expose individuals to harm or otherwise present a safety concern. Despite a move towards increased transparency, the U.K.'s register of beneficial ownership of trusts is only available to those demonstrating a legitimate interest to this information, for example, law enforcement [Gilmour (2020)]. The U.K.'s register of trusts is maintained by His Majesty Revenue and Customs via the Trusts Registration Service. It now covers all U.K. trusts and some non-U.K. trusts set up on or after 6 October 2020. It excludes several types of trust arrangements, such as charitable trusts, pensions, will trusts, and trusts valued under £100 established prior to October 6, 2020. Trustees must disclose information concerning trustee(s), settlor, and beneficiaries of their arrangements. Similarly, HMRC can decline access in circumstances that might expose the beneficial owner to risk of being victim of fraud, blackmail, or suffer from any other harm [Morgan (2022)].

The U.K. has recently introduced a register of overseas entities that own or control U.K. property, via the recent Economic Crime (Transparency and Enforcement) Act 2022. This suggests that the U.K. government recognizes the money-laundering risks inherent within the U.K.'s real estate sector and is continuing to make efforts to enhance beneficial ownership transparency. Beneficial ownership information of U.K. freehold properties, or leases of over seven years issued on or after 1 January 1999 must now be disclosed [The Law Society of England and Wales (2022)]. Further reforms to Companies House are underway, including providing Companies House with the mandate to verify information on beneficial owners submitted to their registers. It remains to be seen how the U.K. will implement future FATF's recommendations or consider future updates to the E.U.'s AMLDs, now that it is outside the membership of the E.U.

[1] Council Directive 2015/849/EU of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) 2012/648 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC, (2015), Official Journal of the European Union, L141, 73-117.

[2] Council Directive 2018/843/EU of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU, (2018), Official Journal of the European Union, L156, 43-57.

[3] WM and Sovim SA v. Luxembourg Business Registers. Court of Justice of the European Union (2022), https://bit.ly/3WFeGWo

Elsewhere, the U.S. has established a central register of beneficial owners through the Corporate Transparency Act. Here, beneficial ownership information of certain corporates must be disclosed to Financial Crimes Enforcement Network (FinCEN). However, it should be noted that information on beneficial owners is not publicly available and is secured by the Secretary of the Treasury within a non-public database only accessible by law enforcement and defined "covered" financial institutions [Gilmour (2022b)]. Covered financial institutions can only access such data to help their customer due diligence compliance duties and only then with their clients' permission. Furthermore, companies having more than twenty full-time employees, publicly listed on the stock market, or with a physical office within the U.S. are exempt from disclosing their beneficial owners. This then understandably raises doubts as to whether the new Corporate Transparency Act promotes a truly transparent beneficial ownership regime.

Global attempts to strengthen beneficial ownership transparency entails challenges for governments and regulated sectors to overcome. Not only must legal frameworks adhere with fundamental rights to privacy in safeguarding individual freedoms, proper infrastructures and processes must also be implemented to support the accurate verification of beneficial ownership information held within registers. Key to this is ensuring that companies and regulated professionals understand their duties surrounding customer due diligence compliance, which is crucial to the know your customer (KYC) principle. The following section discusses this in further detail.

4. CUSTOMER DUE DILIGENCE

It is vital for regulated professionals and other obliged entities to undertake consistent and methodological customer due diligence (CDD) processes to ensure compliance with anti-money laundering regulations in preventing and detecting illicit activity. As part of this process, banks, law firms, and other regulated sectors should support four key aspects integral to the KYC principle:

a. identify and verify the identity of customers,

b. identify and verify beneficial ownership of companies and other legal entity customers,

c. understand the nature and purpose of their clients' transactions and customer relationships, and

d. conduct ongoing monitoring to maintain and update customer information and to identify and report suspicious transactions [Zali and Maulidi (2018)].

Yet, verifying information on beneficial owners can prove difficult when beneficial ownership is obscured through offshore, layered, or otherwise complicated ownership structures. Uncovering beneficial ownership often involves more stringent checks and enhanced CDD processes, beyond the simple checks whereby limited customer information is obtained and less rigorous verification is made – as might be the case for onboarding low-risk clients. Enhanced CDD may involve authenticating beneficial owners' source of wealth through the sharing of financial information between financial institutions, checking information held on company registers, investigating links with associated third parties and transactions, or requiring the customer to provide additional information from a wide variety of sources. Undertaking enhanced CDD will also be appropriate in cases of a perceived higher money-laundering risk, such as for PEPs or clients with links to high-risk countries.

5. DISCLOSING BENEFICIAL OWNERSHIP

Similarly, it is important that company directors and executives understand what information and the circumstances in which information on beneficial owners must be disclosed to the relevant authorities. In the U.S., the U.S. Corporate Transparency Act defines a "reporting company" as a corporation, LLC, or "other similar entity" registered with the U.S. Secretary of State or created overseas and registered to do business in the U.S. The reporting company is required, upon formation and every year thereafter, to file "personally identifiable information" of its beneficial owners to FinCEN. Confusingly, "a similar entity" defined as a reporting company may include a limited partnership or limited liability limited partnership but may not cover law trusts and general partnerships [Shepherd and Manigault (2021)]. Disclosable data include the full name, date of birth, address, and an identification number gained from an official document or unique identifier assigned by FinCEN. There are also many exceptions to disclosure requirements.

In the U.K., the requirements around beneficial ownership disclosure of U.K. companies are centered on private, unlisted entities, as aligned with the provisions of Part 21A of the Companies Act 2006 and the Companies Act 2006 amended by the Small Business, Enterprise and Employment Act 2015. U.K. publicly listed entities, including wholly-owned subsidiaries of publicly listed entities, are not required to disclose information on their beneficial owners. Disclosable information includes the persons of significant control (PSC's) name, date of birth, nationality, home region and country,

service address, residential address, the nature of their control over the company, and the date they became its beneficial owner [Gilmour (2020)]. Paragraph 6 of Schedule 2 to the Economic Crime (Transparency and Enforcement) Act 2022 outlines that a beneficial owner of an overseas entity or other legal entity constitutes someone who:

- holds, directly or indirectly, more than 25 percent of the shares in the overseas entity
- holds, directly or indirectly, more than 25 percent of the voting rights in the overseas entity
- holds the right, directly or indirectly, to appoint or remove a majority of the board of directors of the overseas entity
- has the right to exercise, or actually exercises, significant influence or control over the overseas entity.

Varying disclosure requirements will exist depending on relevant domestic rules, company or legal entity status, and circumstances. It is important, therefore, to check and understand the legal obligations on disclosing beneficial ownership and the mechanisms for disclosure for any given jurisdiction. Many governments are now requiring companies to disclose beneficial ownership information through a central register or amending domestic company laws to enhance the transparency of beneficial ownership. Notably, India updated its company law in 2018 to define "significant beneficial owner" as someone having at least 10 percent ownership of a company, under section 89(10) of the Companies Act, 2013 as amended in rule 2(e) of Companies (Significant Beneficial Owners) Rule 2018. Meanwhile, companies registered in Kenya are now obliged to keep a registry of their beneficial owners and to file this with the state Registrar of Companies [Coste and Meunier (2021), World Bank (2018)]. Such measures highlight the continued efforts governments worldwide are implementing to curb illicit activities and demonstrates the global consensus for ensuring the improved transparency of beneficial ownership.

6. CONCLUSION

This article examines the disclosure of beneficial ownership by exploring the role of company registers and the process of customer due diligence. It demonstrates that beneficial ownership disclosure remains a controversial topic but important policy tool for governments. Companies can serve as effective vehicles in which criminals can evade tax and launder money by masking the identity of the natural person – or beneficial owner – who ultimately controls company assets or activities. Meanwhile, beneficial ownership is crucial for many perfectly legitimate business dealings, like settling trust arrangements, employing shell companies, or facilitating company mergers and acquisitions [Gillis (2019)]. Proper disclosure of beneficial ownership as part of a broader compliance process helps prevent abuses within the corporate and financial sectors and stem corrupt practices, like money laundering and tax evasion. An effective customer due diligence compliance system relies on information on beneficial owners of companies being accurately disclosed, robustly verified, and continuously monitored. Although proper disclosure of beneficial ownership can be arduous, costly, and pose privacy and legal challenges, it is vital in strengthening the transparency of corporate dealings and for maintaining reputational trust in political, institutional, and financial systems.

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