



ENDING SECRECY TO END IMPUNITY: TRACING THE BENEFICIAL OWNER

Shedding light on who benefits from companies is a key defence for stopping corruption. Such information helps to prevent a safe haven to hide the proceeds of corruption and aids in revealing the money trail behind it.

One of the main loopholes in efforts to fight money laundering is that current laws do not require those forming a company to report who ultimately controls it.

Shell companies, secrecy jurisdictions and opaque corporate ownership structures represent the primary methods used by corrupt individuals to hide and stow away their stolen funds.¹ Complex corporate structures spanning across multiple countries are easy to set up and allow corrupt individuals a way to successfully and secretly launder large amounts of dirty money.

Money laundering is not only a crime but it imposes significant costs both on developing and developed countries. According to the United Nations, money laundering globally may reach US\$ 2 trillion annually.² Estimates suggest that half of this amount comes from developing countries,³ a figure which is more than seven times the total inflows they receive from international aid.⁴

Transparency International is calling for publicly accessible registries of beneficial ownership information in order to break the vicious cycle of impunity that hidden ownership allows. The identification of who controls a company and its profits will increase financial transparency and help to stop the corrupt.

THE ISSUE

IDENTIFYING THE LOOPHOLE

Anonymous corporate vehicles such as shell companies, trusts and foundations are the main vehicles used to hide the proceeds of corruption, tax evasion and other crimes. In a review of 213 instances of grand corruption over the last 30 years, the World Bank found that in more than 70 per cent of the cases the ownership of the stolen funds had been disguised through the misuse of corporate entities, half of which were anonymous shell companies.⁵

Money is largely laundered with impunity due to the lack of information about who ultimately owns and controls these legal structures: the beneficial owners. The identity of these people can easily be obscured, for instance by incorporating one or more of the companies in a secrecy jurisdictions — whether be it the Cayman Islands or the US state of Delaware — or by using “nominees” (see side bar).⁶ Public information on beneficial ownership is vital in fighting financial crime because it helps shed light on the actual ownership structure of these companies and their ultimate beneficiaries.

Despite the strengthening of global anti-money laundering standards, such as those set by the Financial Action Task Force (FATF) and the United Nations Convention against Corruption (UNCAC), few jurisdictions require companies to report information on beneficial ownership to their national authorities. Moreover, currently no country makes this information freely available to the public.⁷ This despite a FATF recommendation on “transparency and beneficial ownership of legal persons and arrangements”, which has low compliance among OECD members to date.⁸

The most common way for countries to attempt to comply with international anti-money laundering obligations is to require banks and other financial institutions to conduct due diligence on their customers prior to entering a business relationship with them. This includes, among other requirements, the identification of the beneficial owner. However, experts have noted that compliance with such stipulations remains worryingly low and its efficacy very limited.⁹

Due diligence procedures are fairly easy to circumvent as financial institutions may be negligent or incapable to perform them to the necessary depth. For example, in a 2011 study the UK Financial Services Authority found that the majority of British banks failed to undertake adequate checks on the funds they transferred.¹⁰

IDENTIFYING THE BENEFICIAL OWNER

There are a variety of corporate arrangements, legal structures and ways in which control of a company can be exercised. Clarity is needed as to who controls and benefits from such a legal entity that has been set up. This is required for public authorities to accurately compile a public register and for financial institutions to undertake targeted due diligence procedures.

The concept of beneficial ownership refers to the “ultimate” control of a legal entity, independently of the formal ownership structure. Such control can only be held by a natural person (or a group of natural persons), even when his or her identity is hidden inside complicated ownership schemes.¹¹ At times, it may be hard to identify the ultimate beneficial owner of a corporate vehicle since professional intermediaries may complicitly help to hide who the owner is.¹²

Typically, control in publicly-listed companies is exercised by shareholders, the board of directors or executive officers, although corporate and ownership structures may be designed in such a way that ultimate control is exercised by minority shareholders or external individuals. The identification of the beneficial

BENEFICIAL OWNER VS. NOMINEE

A beneficial owner is the natural person who directly or indirectly ultimately owns, controls or benefits from a company or trust fund and the income it generates. Whether she is the legal owner is irrelevant, as beneficial ownership — in spite of its name — refers to substantive control, not to formal ownership.

The term is used to contrast with the nominee company owners, who might be registered as legal owners of the asset without any benefits. Nominees obscure the real company structure and owners. Professional nominees are paid a fee for their services but otherwise have no interest in the transactions. Nominees can also be family members or friends.

TRUSTS AND CORRUPTION

owners is further obstructed by some ambiguous yet lawful financial instruments, such as bearer shares, which allow individuals to control entities in total anonymity. International guidelines — as put forward by the G20 and FATF — have taken steps to prevent their misuse. Some countries such as Belgium have phased out bearer shares, while the UK is planning to abolish them.¹³

Since the endorsement by the G8, an increasing number of countries are planning to introduce regulations to establish beneficial ownership registers. The UK government has confirmed the intention to create an open, publicly available register on beneficial ownership.¹⁴ The White House also has sponsored a legislative proposal that would require tax authorities to collect information on the beneficial owner of any legal entity organised in any state.¹⁵ However, information would only be accessible to law enforcement officials rather than the public. Currently, investment firms registered with the Security and Exchange Commission (SEC) are asked to disclose the “control persons” in attempt to access such information.

Anti-money-laundering regulations, such as the third and fourth EU AML Directives¹⁶ or the UK Money Laundering Regulations 2007,¹⁷ adopt formal-quantitative criteria for identifying beneficial owners. They require the holding of a minimum percentage of shares, the enjoyment of sufficient voting rights to exercise influence on key decisions, or — in the case of trusts — the control over or the benefit from a certain percentage of the property. Although such criteria successfully identify the beneficial owner in most cases, the reliance on formal ownership arrangements may fail to crack the surface of secretive or informal control structures. While beneficial owners of legitimate business have no reason to seek anonymity, money launderers often exercise control from outside the structure of the company, relying on nominees, close associates and family members. Tracing the actual beneficial owner in such circumstances requires substantial investigative efforts, resources and access to confidential information.

Gathering information on beneficial ownership

Although most countries rely on service providers and financial institutions to collect data on beneficial ownership, public registers of companies remain the main source of information both for investigations by national authorities and for due diligence by financial institutions.¹⁸ Adding information on beneficial owners to existing reporting obligations would therefore be the most cost-effective and efficient choice. Two cost-benefit analyses commissioned by the European Commission and by the UK Companies House show that the benefits of collecting information on beneficial ownership are multiple,¹⁹ as fiscal compliance would increase and enforcement expenses for the government would fall.

Still any type of register of companies will have its limitations. Data, if not kept up to date, may become inaccurate, while information received in good faith is rarely verified.²⁰ This same concern would apply to the creation of public registers on beneficial ownership. They can be an effective tool to fight crime and corruption only if sufficient resources and expertise are allocated to ensure their accuracy.

Given the difficulty in establishing upfront the identity of the beneficial owner, financial and non-financial intermediaries remain of key importance in the collection of information on beneficial owners. Their level of involvement in the “day-to-day” operations of a corporate vehicle makes them an essential source of information about how to find out who are a company’s ultimate controllers. The data they collect should be made available to competent authorities and cross-checked (by financial intermediaries, foreign authorities, business and civil society organisations, media, etc.), against the information available in public registers, in order to highlight discrepancies and improve accuracy. It is therefore important to ensure the collaboration of financial institutions, lawyers, accountants and company service providers in order to follow up on the implementation of their monitoring and reporting obligations, such as those

Trusts are — after companies — the second most common vehicle for laundering illicit funds. However, determining the beneficial owners of trusts is complicated by the fact that in these legal arrangements control and ownership are explicitly separate.

Depending on the trust set up, the settlor, the beneficiary and the trustee could all qualify as beneficial owners. Given this unique characteristic, the collection of beneficial ownership information for trusts require a specific but equivalent approach as is used for companies. Additional analysis is required to identify the elements that should be included in the public domain and regulated.

Frameworks do exist that could serve as a model.

The G8 “principles on transparency of legal persons and arrangements” require trustees to collect beneficial ownership and make this accessible to public authorities. According to FATF recommendations, governments shall make such information accessible to financial institutions and corporate service providers. The draft of the fourth EU directive against money laundering proposes to take this further, requiring EU members to make this information available in public registers.

enshrined in FATF recommendation 10, as well as to collectively determine sanctions for the failure to do so. In order to increase compliance, governments which do not already do so should consider requiring the formal licensing of corporate service providers, as a tool to more effectively monitor their fulfillment of anti-money laundering obligations.

Making ownership details publicly and freely available — rather than exclusively accessible to law enforcement authorities — has several advantages. First of all it would greatly benefit financial institutions and company service providers, as it would make it easier for them to obtain information needed to effectively comply with due diligence duties. This advantage, however, should not exempt obliged entities from meeting their anti-money laundering obligations. For beneficial ownership registers to be meaningful, the information they contain must be constantly verified. This would happen only if they are used to facilitate rather than replace mandatory due diligence procedures.

A second advantage is that public registers would greatly simplify the costly and complex process of mutual legal assistance, facilitating the exchange of information both from the sender and from the receiver's side. Access to information on beneficial ownership would also benefit the business community, allowing them to make better informed investment decisions about the companies they are trading with. Finally, having beneficial ownership information in the public domain would increase the public accountability of companies and public officials, helping civil society and the media to assess their structures.

RECOMMENDATIONS

GOVERNMENTS MUST:

- Make information on beneficial ownership of companies freely and publicly accessible in machine-readable formats. As a first step towards full disclosure, all collected information should be shared with law enforcement bodies.
- Expand the scope of public registers of companies to include information on the beneficial owner(s).
- Require trustees to collect information on beneficiaries and settlors of the trusts they administer, to make such information accessible to tax and law enforcement authorities and to report suspicious activities.
- Ensure that information contained in public registers on beneficial ownership is accurate and up-to-date.
 - Establish a legal obligation for companies to notify authorities of changes within an agreed time period or to be subject to sanctions.
 - Designate existing agencies with related functions (such as a securities regulator) to oversee and verify registries and leverage existing capacities.
 - Subject trust and company service providers to formal licensing.
- Support global efforts such as through the G20 and G8 to ensure and implement the transparency of companies and legal arrangements.
- Require, as an interim measure, all companies that participate in public tenders to disclose their beneficial owner, as well as the final beneficiary of associated and parent companies.

SERVICE PROVIDERS

Service providers such as lawyers, notaries and accountants play a key role as gatekeepers for setting up corporate vehicles. They may be used to perform transactions with financial institutions or conduct and arrange dealings on the client's behalf. Given the high risk of involvement in money laundering activities, these professions must not be exempt from regulations to which financial institutions are subject. However, in a number of jurisdictions, anti-money laundering requirements do not apply to them. For instance, in the United States, legal professions and service providers are not subject to specific AML requirements.

FINANCIAL INSTITUTIONS MUST:

- Conduct enhanced due diligence procedures on clients selected on the basis of risk, double checking information with public registers on beneficial ownership to complement other sources of information.
- Ensure a thorough investigation of all the particulars of a company's ownership before agreeing to do business with a client.
- Require all clients to notify relevant authorities of any changes to their corporate structure in advance of modifications.
- Ensure the reporting of all suspicious activities as pursuant to existing AML regulations.

CIVIL SOCIETY MUST:

- Pressure governments and companies to adopt measures to raise the bar on the regulation and disclosure of beneficial ownership for corporate vehicles.
- Use public registers of companies to cross-check and verify owners and help to root out corrupt structures.
- Conduct additional research on trusts and the required levels of public disclosure to close a backdoor to corruption and illicit flows.

TRANSPARENCY VS. PRIVACY

Collecting personal information in order to identify beneficial owners may raise privacy concerns. However, as stated in the European Convention on Human Rights (article 8), interference from state authorities may be justified if provided by law and necessary in a democratic society to prevent crime and promote the economic well-being of the country.

All that is required for a public register on beneficial ownership would be: name, birth date of the beneficial owner, business address, nationality and description of how ownership or control is exercised.

The collection of this information is hence highly likely to pass the proportionality test largely employed in human rights law and therefore not violate one's right to privacy.

¹ OECD, *Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes*, 2001, [/www.oecd.org/corporate/ca/43703185.pdf](http://www.oecd.org/corporate/ca/43703185.pdf).

² UN Office of Drugs and Crime, "Money Laundering and Globalisation" at www.unodc.org/unodc/en/money-laundering/globalization.html.

³ Global Financial Integrity, *Illicit financial flows from Developing Countries: 2002-2011*, 2013.

⁴ OECD, "Development: Aid to developing countries falls because of global recession", available at: www.oecd.org/development/developmentaidtodevelopingcountriesfallsbecauseofglobalrecession.htm.

⁵ Stolen Asset Recovery Initiative, *Puppet Masters: how the corrupt use legal structures to hide stolen assets and what to do about it*. 2011.

⁶ Global Witnesses, *Poverty, Corruption and Anonymous Companies*, 2014.

⁷ Christian Aid and Global Witness, *Company ownership: which places are the most and least transparent?*, November 2013.

⁸ OECD, *Measuring OECD responses to illicit financial flows from developing countries*, 2013.

⁹ Stolen Asset Recovery Initiative, *Puppet Masters*; Global Witnesses, *Poverty, Corruption and Anonymous Companies*, 2014.

¹⁰ FSA, *Banks' management of high money-laundering risk situations*, 2011.

¹¹ Bownet Project. *The identification of beneficial owners in the fight against money laundering*, 2013; Stolen Asset Recovery Initiative, *Puppet Masters*.

¹² Stolen Asset Recovery Initiative, *Puppet Masters*.

¹³ UK Government, "Tough action promised on hidden company owners" [Press release], 21 April 2014

¹⁴ UK Government, 2014.

¹⁵ The White House Blog, "Beneficial Ownership Legislation Proposal", 4 April 2014.

¹⁶ Directive 2005/60/EC of 26 October 2005 and the proposal for a directive on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing, European Commission, 5 February 2013.

¹⁷ Money Laundering Regulations 2007, SI 2007 No. 2157.

¹⁸ Stolen Asset Recovery Initiative, *Puppet Masters*.

¹⁹ HM Treasury/DTI, "Disclosure of beneficial ownership of unlisted companies," 2002; Transcrime. "Cost benefit analysis of transparency requirements in the company/corporate field and banking sector relevant for the fight against money laundering and other financial crime", 2007.

²⁰ Bownet Project, "The identification of beneficial owners" (Milan, Italy: Transcrime, 2013).

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Transparency International
International Secretariat
Alt-Moabit 96
10559 Berlin
Germany

Phone: +49 - 30 - 34 38 200
Fax: +49 - 30 - 34 70 39 12

ti@transparency.org
www.transparency.org

blog.transparency.org
[facebook.com/transparencyinternational](https://www.facebook.com/transparencyinternational)
twitter.com/anticorruption