TRANSPARENCY INTERNATIONAL
the global coalition against corruption

ENSURING EFFECTIVE IMPLEMENTATION OF THE NEW GLOBAL STANDARD

Response to FATF's guidance on the revised Recommendation 25

PROPOSALS FOR GUIDANCE ON RECOMMENDATION 25

Transparency International welcomes the opportunity to provide comments on the updated guidance on Beneficial Ownership and Transparency of Legal Arrangements (Recommendation 25) released by the Financial Action Task Force (FATF) for publication consultation. In general, the guidance provides several welcome clarifications and improvements upon the Interpretive Note for Recommendation 25, particularly its observation that in the absence of central registers for express trusts (hereinafter "trusts") or similar legal arrangements, identification of beneficial owners may be difficult.

While Transparency International agrees with this general sentiment, the guidance would benefit from a fuller account of the many ways that a multi-pronged approach involving central registers would advance the overall effectiveness of Recommendation 25, complemented by real-world examples. Recent investigations underscore the need for such an approach, including revelations about the intentional misuse of trusts for disguising ownership[1] and sanctions evasion[2]. While is possible that trusts have historically been used for benign reasons, in the absence of reported and verifiable data about the number, purpose or beneficial ownership of trusts with sufficient links to a jurisdiction, the scale of abuse of trusts and similar legal arrangements remains, by definition, unknowable.[3] The guidance would therefore also be strengthened by not erring towards setting the 'trigger point' for additional focus by authorities on a trust's purpose too high; a situation where the settlor coincides with the beneficiary (particularly if it is the only beneficiary) may be enough to merit further investigation.

The ultimate impact of Recommendation 25 therefore hinges upon whether countries pursue its implementation to meaningful effect. Noting that the guidance presently offers a flexible menu of legal compliance measures for ensuring beneficial ownership information is adequately recorded and reported upon request, Transparency International believes that FATF now has a valuable opportunity to monitor and assess the effectiveness of differing approaches towards fulfilling Recommendation 25. For example, while the guidance offers a 'pros and cons' consideration of the central register approach, a similar assessment of alternative measures would provide countries with a more rounded perspective of the pros and cons of a non-register approach, and the absence of a multi-pronged approach. As noted in our earlier submissions, Transparency International's position is that Recommendation 25 should have adopted the same multi-pronged approach as Recommendation 24,[4] and we look forward to future evaluations by FATF on what constitutes 'best-practice' implementation in this regard.

The following feedback mostly provides direct responses to the questions posed by FATF in its consultation on the guidance for Recommendation 25, excluding only question 3. The feedback concludes with an additional observation on the

[1] Vincent Freigang and Maíra Martini (December 2023). *Loophole Masters: How Enablers Facilitate Illicit Financial Flows from Africa* (Transparency International)

[2] Transparency International (November 2023), Cyprus Confidential: Gaps in supervision give free rein to enablers abusing financial secrecy; CBS New – 60 Minutes (January 2023), Cyprus: Searching for the money of Russian oligarchs

[3] See: FATF and APG (April 2015), Anti-money laundering and counter-terrorist financing measures – Australia, Fourth Round Mutual Evaluation Report (MER); FATF (April 2021), Anti-money laundering and counter-terrorist financing measures – New Zealand, Fourth Round MER

[4] Transparency International (July 2022), Paving the way for enhanced trust transparency; Transparency International (December 2022), Closing the trusts loophole

distinction between the provision of corporate and financial services to traditional legal representation, noting that confidentiality should only be applied in the latter case and should never be used to cover up complicit behaviour by the lawyer.

In November 2023, FATF opened up a public consultation, welcoming comments concerning its updated Guidance on Beneficial Ownership and Transparency of Legal Arrangements (Recommendation 25). FATF seeks insights on the following issues:

1. Are there any other *purposes* of express trusts beyond what have been set out in the Guidance?
2. Are there *other potential scenarios* concerning beneficiaries that should be included in this Guidance?
3. What other *activities* may be included in the definition of trust administration, if any?
4. Are there other *additional mechanisms available to ensure access to beneficial ownership information* in the context of trusts?
5. What are the suggested approaches to identify, assess, and mitigate the ML/TF risks linked with different types of legal arrangements (trusts governed under domestic law, foreign trusts administered in the country, and foreign trusts having sufficient links with the country)? What trends can be identified?
6. Under which circumstances would a non-professional trustee be chosen? Which types of trusts are typically administered by such non-professional trustees?
7. How can countries achieve the obligations on non-professional trustees more effectively?
8. Are there any other *purposes* of express trusts beyond what have been set out in the Guidance?

PURPOSES OF EXPRESS TRUSTS

Transparency International appreciates that the list of trust purposes provided in the draft guidance is not intended to be exhaustive. However, noting that all countries will benefit from a proper assessment of existing legal arrangements with sufficient links to their jurisdiction and the money laundering risks they pose, proper and ideally loophole-free regulation demands a fully rounded appraisal.

Recognition that trusts and similar legal arrangements possess qualities that are inherently vulnerable to abuse should not be controversial. Although a detailed analysis of the ways trusts can be abused may not be necessary in this section (as section 3 returns to the topic), section 2.1.13 could still acknowledge, for example, that regardless of the nature of a trust, the historically private nature of trusts reinforces the need to specifically consider and assess each arrangement's functions and characteristics in line with applicable requirements and ML/TF risks.

The inclusion of box 2.1 on charitable trusts is welcome, as this usefully demonstrates why the creation exemptions for trustees (professional or non-professional) for certain kinds of trusts would serve as a potential gateway to heightened ML/TF risks.

SCENARIOS CONCERNING BENEFICIARIES

The guidance is an improvement upon recommendation.25 and its interpretive note in distinguishing between 'objects of a power' and a 'class of beneficiaries'. There may be merit to adding both concepts to the FATF glossary for ease of reference.

One beneficiary scenario warranting further attention is disbursement by a trustee of trust benefits, or provision of access to trust assets, to a third party in a way that produces an 'indirect beneficiary'. This could include, for example, the use of trust funds under the guise of administrative expenses to cover tuition fees or loan repayments on behalf of an unnamed or 'indirect beneficiary',or allowing an indirect beneficiary access to assets held by the trust such as real estate, yachts or similar without ceding any legal ownership of them.[5] As one measure for countering this type of trust abuse

[5] Andres Knobel (December 2022). 'No, the proposals are not enough': our response to FATF consultation on Recommendation 25 (Tax Justice Network)

would be mandatory registration of the identities of such 'indirect beneficiaries', the guidance could alternatively address this scenario in section 3.5, 'mechanisms for preventing and mitigating risk'. At present, only paragraph 2.3.40 references the fact that beneficiaries of trusts can benefit through indirect means.

In terms of trustee obligations towards beneficiaries, paragraph 45 could add that trustee knowledge of beneficiaries is essential not only to the proper consideration of beneficiaries' interests, but also in meeting their own record-keeping and/or reporting obligations under this recommendation.

MECHANISMS TO ENSURE ACCESS TO OWNERSHIP INFORMATION

While recognising this guidance document is based upon the settled text of Recommendation 25 and its interpretive note, Transparency International's position remains that central registers should be an essential lynchpin within a broader multi-pronged approach to ensure the availability of information on trusts and similar legal arrangements.[6] Whereas the draft guidance offers a menu of several potential mechanisms for identifying the beneficial owners of trusts, a central register maintained by government authorities and complemented by other mechanisms such as tax or asset registers remains best practice for capturing and distributing comprehensive and accessible beneficial ownership information, enabling proactive investigations and ensuring trust transparency. Sole or over-reliance on the private sector or trustees as sources of beneficial ownership information is not enough to effectively combat ML and TF risks. In fact, recent investigations reveal corporate and trust service providers in Cyprus not only failed to meet their obligations, but in fact deliberately concealed such risks and enabled Russian clients to evade sanctions stemming from Russia's invasion of Ukraine.[7]

Clear and positive statements on the value of working towards the establishment of mandatory central registers for trusts would enable the timely access to beneficial ownership of all parties to the trust by competent authorities. It would advance cooperation efforts across jurisdictions in combatting ML and TF through trusts and similar legal arrangements. As noted in our earlier submissions, certain FATF members have confirmed that due to their lack of a central register, they have found it impossible to even ascertain the number of trusts that exist within their jurisdiction.[8]

Transparency International therefore agrees with the observation in Section 3.5.78 of the guidance that in the absence of a mandatory central register for trusts, "a country may find it difficult to establish the extent to which there is foreign use of trusts governed under its law…". However, we would also add that without such mechanisms, it will be especially difficult to fulfil the guidance advice in section 1.2 that "[c]ountries should consider facilitating access to beneficial ownership and control information by financial institutions (FIs) and Designated Non-Financial Businesses and Professions (DNFBPs) undertaking the requirements set out in R.10 and R.22," and also section 8 on facilitating the "efficient and rapid exchange of beneficial ownership information across jurisdictions for the purpose of ML and TF investigations." Mutual evaluations conducted under FATF's own guidance have found that the existence of a foreign trust within a company's ownership structure is a predictable failure-point when attempting to identify a beneficial owner(s).[9]

Section 5 would thus benefit from real-world examples where central registers have been introduced to bolster a jurisdiction's ability to record and make available beneficial ownership information. This would show not only the real-world impact of central registries, but also that they are more common than may be realised. As Tax Justice Network's research has shown, 65 countries have already instituted some sort of register with beneficial ownership reporting requirements,[10] including all 27 EU members following the EU Anti-Money Laundering Directive.

[6] Transparency International (July 2022)

[7] Organized Crime and Corruption Reporting Project (November 2023), Cyprus Confidential; International Consortium of Investigative Journalists, About the Cyprus Confidential investigation

[8] FATF and APG (April 2015), Australia MER; FATF (April 2021), New Zealand MER

[9] FATF (September 2016), Anti-money laundering and counter-terrorist financing measures – Canada, Fourth Round MER

[10] Andres Knobel and Florencia Lorenzo (July 2022), Trust registration around the world: The case for registration under FATF Recommendation 25 (Tax Justice Network)

'Pros and cons' considerations for non-register measures

The guidance highlights some of the challenges countries may face when implementing a registry approach and also proposes alternative and complementary measures. To make clear to countries the pros and cons of each approach, the guidance could follow the same format when presenting alternatives to the non-registry approach.

For example:

+ Countries that opt for having information collected and made available through tax authorities should be aware of limitations to information sharing with other competent authorities, particularly within a reasonable timeframe. Whether a foreign jurisdiction's tax authority can pass on information upon request from another competent authority must be examined in light of the confidentiality and data safeguards included in the legal instrument providing automatic tax information exchange.
+ Countries relying on sector-specific registers, like real estate, might have access to information of only a subset of trusts with connections to the country.
+ Countries that rely on agents or service providers to provide information only upon request run the risk of missing signs of ML that would have surfaced under a registry approach. Under this scenario, authorities also cannot guarantee access to information pertaining to trusts established without the use of trust service providers, or indeed any identified reporting entity, a function of trusts being borne out of private law.
+ Where countries do not regulate or impose reporting obligations upon DNFBPs, the burden lies on authorities to establish a link between a trust and a DNFBP.

Though not an exhaustive list of the 'cons' associated with alternative measures to the registry approach, these examples should all be considered with respect to section 5.5.1.135 that "competent authorities should have sufficient knowledge of which public authority or body or other person/entity holds adequate, accurate, and up-to-date basic and beneficial ownership information of the trusts or other similar legal arrangements, trustees and trust assets, and how to access that information."

No validation without registration

The effectiveness of the registry approach depends upon thorough implementation, monitoring, verification and enforcement. When discussing potential 'proportionate and dissuasive' sanctions on the failure to accurately declare beneficial ownership information, the guidance's suggestions in 5.1.125 should include the registration of any trust or similar legal arrangement and the identification of its beneficial owners as a precondition for validity (corresponding to 3.5.77 and also relevant to section 6). Such a requirement would preclude unregistered protectors or trustees from being able to make any decisions, trust benefits from being disbursed to beneficiaries, or similar parties with an effective controlling responsibility from defrauding the trust. This is a powerful incentive to fulfil registration of beneficial ownership obligations.

In addition, the trigger for conducting a risk assessment of any trust party or activity with a 'sufficient link' to a trust, whether governed under local or foreign laws, should not be too high. The final example in Box 5.1, which lists information that a central registry should capture, would better align with earlier guidance in 3.4.72 if it incorporated a suggestion along the lines of '(vi) sufficient links to foreign created legal arrangements such as ownership of significant assets/real estate/other local investments'.

The use of 'significant' as a prerequisite for a risk assessment could be removed, as arbitrary thresholds can easily be bypassed by introducing additional controlling entities (thereby bringing the proportion of each entity's controlling share below any given threshold). Instead, jurisdictions should be able to establish 'sufficient links' through the residence of any party to a trust, the existence of locally held asset(s) and bank account(s), the use of local service providers to the trust (including enablers such as lawyers, accountants, financial and/or tax and/or investment advisors), the use of local business addresses by any party in connection with the trust.

Notwithstanding the nuances of trust law or law governing other legal arrangements in different countries (124), carving out exceptions for certain types of trusts or similar arrangements will create opportunities for abuse.

Access to other stakeholders

Opening trust registers to individuals and organisations who can prove a legitimate interest should also be listed as mechanisms for ensuring access to beneficial ownership information. An actor with a legitimate interest (e.g., civil society organisations or media working on money laundering issues, or predicate offences such as corruption and tax evasion) should be able to request access to data. As Transparency International has noted in previous submissions, trust registers with public access also offer efficiency dividends for accessing beneficial ownership information and identifying ML concerns.[11] Such registers reduce red tape and waiting times for approval of requests from domestic and foreign competent authorities, assist FIs and DNFBPs in fulfilling their CDD obligations, as well as assist regulators and public watchdogs with recognised legitimate interests.

Need to identify best practices

How information on the nature of a legal arrangement and its beneficial owners is captured also matters. Recommendation 24 guidance is clearer on the importance of consistency of approaches and interoperability of reporting systems run by competent authorities. Though mandatory central registers would be the most sensible mechanism for promoting interoperability among jurisdictions, current guidance on how beneficial ownership information on trusts should be delivered to requesting stakeholders is fuzzy, which could be a stumbling block for Recommendation 25's effectiveness. Currently, the recommendation does not even require those obligated to record beneficial ownership information to produce their records in electronic format, let alone a standardised form. While recognising the variety of forms trusts and similar legal arrangements can take, this issue should be monitored over time and addressed in any future note on best practices.

Section 5, and the guidance in general, would also benefit from clarification on what constitutes 'up-to-date' information. While Transparency International has proposed 14 days, FATF's guidance for Recommendation 24 provides one month as an indicative timeline for reporting beneficial ownership changes to legal persons.

Transparency International welcomes the opportunity to reiterate these points in future FATF work on best practices for implementing Recommendation 25.

APPROACHES TO IDENTIFY, ASSESS AND MITIGATE RISKS

An effective anti-ML/TF system requires adequate assessment of risks. In the case of trusts, insufficient registration requirements or their total absence complicates any assessment of how many trusts even exist, while making detection and investigation into wrongdoing more difficult and resource-intensive. Transparency International welcomes guidance updates on approaches to identifying, assessing and mitigating trust-related ML/TF risks but, as in the previous answer, reiterates the importance of clear concepts and definitions in such undertakings. In particular, the presence of any party to a trust within a jurisdiction may constitute 'sufficient links' with another jurisdiction to warrant their consideration and inclusion in the guidance, especially in the case of complex trusts.

For example, section 3 presently focuses on ML/TF risks associated with the presence and actions of trustees or persons holding equivalent positions in similar arrangements. Yet other parties to a trust or similar arrangement that may indicate the existence of ML/TF risks within a jurisdiction include the settlor(s), beneficiary(ies) as well as any other natural persons exercising ultimate control over a legal arrangement. Consideration should be given to these additional elements, especially in determining whether foreign legal arrangements have sufficient links within a jurisdiction.

Other indicators of a 'sufficient link' include the presence of assets, bank accounts or business address in connection with a trust. With respect to registration of trust administered assets, this would be in line with the European Union's 5th Anti-Money Laundering Directive (Article 31, 3a), which establishes that when trustees or persons in similar positions acquire real estate assets and/or enter into business relationships on behalf of a trust, the jurisdiction where this occurs is to host the beneficial ownership information of the legal arrangement in their register.

As the FATF draft guidance notes, in the absence of mandatory central registries for trusts, assessment

[11] See also: Tymon Kiepe (May 2021), Making central beneficial ownership registers public (Open Ownership)

of ML/TF risks within and across jurisdictions may remain difficult. Transparency International encourages FATF to monitor the implementation and effectiveness of risk assessments on trusts and similar arrangements between jurisdictions with and without central registers, particularly in advance of any forthcoming best practice note for Recommendation 25.

NON-PROFESSIONAL TRUSTEES

Transparency International agrees that both professional and nonprofessional trustees should be treated alike and obliged to meet the same set of record-keeping and reporting requirements under Recommendation 25.

Nevertheless, in practice, it will be difficult to hold non-professional trustees to the same standard as their professional counterparts. Enhanced risks associated with the use of non-professional trustees are various, including inadequate understanding of ML risks, inability to adequately identify parties to a trust or verify provided information, and a higher conflict of interest risk due to the likelihood of having a close connection to the settlor. Unlicensed, unregistered non-professional trustees are also harder for competent authorities to identify and seek information from. These additional risks place an unnecessarily high burden on supervisors than is the case with trained and licensed professional trustees.

When it comes to their obligations, again, Transparency International sees no reason for non-professional trustees to be held to a different standard than professional trustees. Rather than place an additional burden on regulators or jurisdictions to introduce specific supervision mechanisms for non-professional trustees, Transparency International endorses the end of unregulated and unlicenced trustees. The complexities and risks associated with trust administration, especially in the context of AML/CFT, necessitate that all trustees be licensed professionals.

The professionalisation of current nonprofessional trustees would enable countries and their supervisory and law enforcement authorities to account for trustees under their jurisdiction, make it easier to oversee compliance with anti-money laundering obligations, sanction noncompliance, as well as to know who to contact in order to obtain essential information on trusts and their beneficial owners.

To mitigate potential challenges, countries should streamline and clearly communicate the process by which one obtains a trustee licence, as well as provide training and guidance on compliance requirements and anti-money laundering obligations.

It is worth noting that under a registry approach, where registration of a trust and all beneficial owners is a precondition to the validity of a trust, settlors will be strongly incentivised to appoint professional trustees to reduce the risk the trust is defrauded by non-professional trustees.

Where countries do not shift towards mandatory professionalisation of trustees, authorities will need to make available comprehensive training programs that ensure non-professional trustees can learn what ML risks are associated with trusts and how to comply with reporting obligations. Such training would necessarily require components on adequate record-keeping, working with authorities and avoiding conflicts of interest. Under this approach, supervisors would also need to engage in active outreach about such training programmes with non-professional trustees, given the latter would not be registered and therefore unknown to authorities.

ADDITIONAL REMARKS

The inclusion of issues relating to the legal profession in section 7.2.2. addresses concerns regularly raised by legal professionals seeking exemptions from anti-money laundering obligations on the basis of client confidentiality. However, such concerns should not impede regulation of these types of services. In the case of lawyers, in particular, a distinction between the provision of corporate and financial services should be made compared to traditional legal representation. Client confidentiality should only be applied in the latter case and should never be used to cover up complicit behaviour by the lawyer.

For any enquiries, please contact

Maíra Martini, Head of Policy & Advocacy (Interim), mmartini@transparency.org

Hugh Jorgensen, Policy & Advocacy Coordinator, hjorgensen@transparency.org

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/en/blog
Facebook: /transparencyinternational
Twitter: @anticorruption