Who Are You?

Beneficial Ownership of Legal Persons and Legal Arrangements

Recommendations for an Audit Programme to Assess Compliance with the Requirements

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Contents

Disclaimer

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With the exception of extracts from publicly-sourced documents and the reference materials, the contents of this paper solely represent the experiences and views of the author, and should not be interpreted as representing the views, opinions, or policies of the QFCRA or any past employer.

Executive Summary

Achieving effective compliance remains an ongoing, and expensive, challenge for financial services firms across the globe.

While the EU is leading the charge to improve transparency of beneficial ownership and access to beneficial ownership data, many G20 countries are significantly lagging behind, including Canada, South Korea, the United States, Russia, China, Australia, India, and South Africa. Some other countries, most notably Offshore Financial Centres (OFCs), also known as tax havens, are lagging even further behind.

While such disparities of standards and practice between jurisdictions remain, criminals will continue to exploit the opportunities they offer.

The Panama Papers and other data leaks have exposed the role of tax havens, and show that tax havens continue to play a key role in facilitating the laundering of criminal proceeds. Numerous global scandals and high-profile legal cases in the last few years show that criminals continue to flourish. Data indicate that criminals are able to successfully retain approximately 99% of profits from their illegal activities,[1] with one commentator describing the Financial Action Task Force (FATF) AML/CFT model as "almost completely ineffective."[2] It is inconceivable that the FATF model will be abandoned, and therefore it is incumbent on national governments, law enforcement agencies, and private sector financial services firms to raise their game.

Key to these criminals' success is their ability to obscure their ownership of tainted assets while still retaining control over them. This is most commonly achieved through the abuse of legal persons and legal arrangements (LPAs). Obscuring beneficial ownership is therefore a key part of the laundering process, while the obverse remains an area of ongoing challenge for financial services firms.

This paper offers some practical recommendations to auditors assessing compliance with the beneficial ownership requirements in real-world scenarios in private-sector firms. While it has the goal of making audit processes more effective, it can serve equally as a guide for both the first and second lines of defence in an operational context.

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1 https://www.europol.europa.eu/publications

2 https://www.emeraldinsight.com/doi/pdfplus/10.1108/JFC-08-2017-0071

Opening Thoughts

We are all familiar with the scenario of a law enforcement press release announcing a successful money laundering prosecution, jail term and associated confiscation/forfeiture order, and the comment that the outcome sends a serious deterrence and punishment message to criminals intent on trying to profit from crime.

Each victory against petty or organised criminals is a good outcome for society, but these victories are all too infrequent and often minor. Cases only occasionally involve a "big fish," and the confiscation/forfeiture amounts are often not particularly significant when viewed in the bigger picture.

Recent research[3] by Dr. Ron Pol, covering certain major economies, suggests that criminals successfully retain approximately 98.8% of their criminal proceeds. Europol has made a similar estimate in a European context.[4] Pol concludes that "the current AML/CFT model is almost completely ineffective in disrupting criminal finances and profit-motivated crime."

In the light of this statistic, the well-known adage "crime doesn't pay" appears more well-known than accurate. However, this should not be perceived as an unqualified criticism of law enforcement worldwide, which virtually without exception operates with insufficient resources in an extremely difficult environment. Financial services firms must also reflect on how they can do better in the fight against ML/TF.

One area for improvement is in the effectiveness of customer due diligence (CDD) processes, particularly in regard to understanding the beneficial ownership of LPAs, something that has been highlighted as a key area of risk by the joint FATF/Egmont Group.[5] Effective execution[6] of CDD processes continues to be problematic for financial services firms despite massive (and continuously rising) compliance-related expenditure.[7]

This has been amply illustrated by the numerous money laundering and terrorist financing scandals referenced later in this paper, but if emphasis were needed, then

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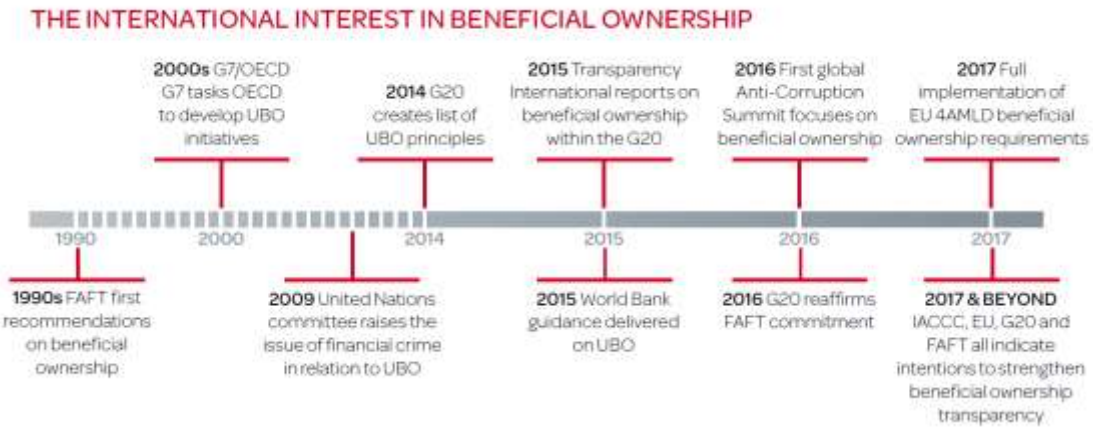
3 Same as 2.
4 Same as 1.
5 http://www.fatf-gafi.org/media/fatf/documents
6 https://www.fintech.finance/01-news/typical-uk-bank-will-waste-10m
7 https://www.fintech.finance/01-news/anti-money-laundering-compliance-costs

the recent news[8] about Deutsche Bank's ongoing struggle to achieve an acceptable standard of CDD compliance, despite its scale, sophistication, and resources, shows that no firm or industry sector can be complacent about the need to improve. The worst case scenario is that the CDD process is perceived as a "tick-box" paper chase, leading to it being seen as little more than the robotic collection of documents and the recording of information. The best case scenario is that firms have appropriate compliance cultures and carry out effective due diligence on customers. However, even at the best firms, ineffective implementation is a constant risk.

The Global Regulatory Landscape and Latest Developments

The graphic below[9] summarises the development of international standards relating to beneficial ownership until 2017, with a marked increase in initiatives since 2014. This paper cannot address all international initiatives, but will focus on key developments and key jurisdictions such as the EU, the Unites States, and OFCs. A significant ongoing issue is that while progress has been made internationally on transparency of beneficial ownership, implementation remains uneven across jurisdictions.



FATF has been successful in rolling out its evolving *40 Recommendations*[10] across much of the globe since its inception in 1989. For the purposes of this paper, FATF Recommendations 1 (the risk-based approach), 10 and 22 (CDD), and 24 and 25 (transparency and beneficial ownership of LPAs) are particularly relevant.

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8 https://www.reuters.com/article/us-deutsche-bank

9 http://www.lexisnexis.com/pdf/The-Hidden-World-of-Beneficial-Ownership.pdf. The "FAFT" error in the 1990s narrative is embedded in the original graphic and cannot be changed.

10 http://www.fatf-gafi.org/media/fatf/documents/

A key obligation is that a firm must "know its customer"—i.e., establish a customer profile and apply a risk rating commensurate with the assessment of the ML/TF risk the customer presents. This includes identifying, and, where applicable, verifying the identity of the customer. This extends to the ultimate beneficial owners (UBOs) and controllers of LPAs.

The Glossary to the *40 Recommendations* defines beneficial owner as follows:

"*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.*"

This takes the concept of beneficial ownership beyond that of pure legal ownership, extending to natural persons who own shares or voting rights in a legal entity and including those who exercise control (who may not be the owners of shares or voting rights). This also captures the scenario of natural persons acting in concert,[11] something that may reflect an attempt to dilute individual shareholdings to a level where verification of the individuals' identity may not be required. It also captures the scenario of straw men or proxies[12] acting on the instructions of a natural person or persons in the shadows, i.e. those not featured on any corporate documentation.

In the case of legal arrangements, FATF requires that persons requiring to be identified are the settlor, the trustee(s), the protector (if any), the beneficiaries or class of beneficiaries, and any other natural person exercising ultimate effective control over the trust or other legal arrangement.

Implementation Gaps Offer Criminals Opportunities for Jurisdictional Arbitrage

Even among the founding and early FATF member countries, gaps in implementation of aspects of the FATF framework have been exploited by criminals[13] and remain unaddressed or only recently addressed: e.g., Australia's Designated Non-Financial Businesses and Professions (DNFBPs) are still not yet subject to the country's AML/CFT regime;[14] New Zealand's lawyers and conveyancers were only made subject to the

11 Acting as one e.g. agreeing to vote on a resolution in the same way.
12 Sometimes also referred to as a benami.
13 http://www.abc.net.au/news/2017-07-13/should-australias
14 https://www.gibsondunn.com/wp-content/

national AML/CFT regime[15] in July 2018; and the FATF has described the United States' beneficial ownership disclosure requirements as "seriously deficient" and that the "lack of timely access to adequate, accurate and current beneficial ownership information remains one of the fundamental gaps in the U.S. context."[16]

The advocacy group Tax Justice Network has commented: "While the United States has pioneered powerful ways to defend itself against foreign tax havens, it has not seriously addressed its own role in attracting illicit financial flows and supporting tax evasion" and makes the observation that it is a "tax haven for foreigners."[17]

The federal government's attempts to bring the 50 states in the United States into line, through the proposed 2017 TITLE Act,[18] have been vigorously opposed by the states themselves, primarily because of the perceived threat to each state's revenues. Matthew Biben describes this as "a classic case of competition causing a race to the bottom, making it difficult for any one State to do the right thing."[19] It also allows criminals to take advantage of jurisdictional arbitrage in states such as Delaware, Nevada, and Wyoming.

The bill[20] remains under scrutiny at the committee stage in the Senate to date. Section 2 of the bill offers the sobering observations that "a person forming a corporation or limited liability company within the United States typically provides less information to the state of incorporation than is needed to obtain a bank account or driver's license", and that "Dozens of internet websites promote states with particularly lax beneficial ownership transparency requirements as attractive locations for the formation of new corporations, essentially inviting terrorists and other wrongdoers to form entities within the United States." However, the final FinCEN CDD Rule for financial institutions did come into force in May 2018 (see below).

The Challenge of Compliance with Overlapping but Different Regulatory Regimes

While FATF suggests a threshold of 25% in relation to beneficial ownership of an LPA, different standards are applied at a supranational level, in different jurisdictions, and

15 https://www.lawsociety.org.nz/news
16 http://www.fatf-gafi.org/countries/u-z/unitedstates/
17 https://www.financialsecrecyindex.com/PDF/USA.pdf
18 True Incorporation Transparency for Law Enforcement Act
19 https://www.debevoise.com/~/media/files/insights
20 https://www.congress.gov/bill/115th-congress/senate-bill/1454

by different regulatory regimes within individual jurisdictions. This makes satisfying the beneficial ownership requirements a complex problem for financial services firms worldwide. For instance:[21]

- U.S. Foreign Account Tax Compliance Act – a 10% or below ownership threshold for foreign investment vehicles, and 10% or more for a substantial U.S. owner;
- OECD Common Reporting Standards – a 10% ownership threshold;
- U.S. Office of Foreign Asset Controls – an LPA itself becomes a blocked person if it is 50% owned, directly or indirectly, by a blocked person;
- U.S. FinCEN Final CDD Rule – directly or indirectly, 25% or more of the equity interest in an LPA;
- The EU Fourth AML Directive – 25% shares or voting rights in a corporate entity (or the natural person(s) holding senior managing positions if identifying UBOs has not been possible);
- U.S. Dodd-Frank Act Sections 13(d) and 13(g) – beneficial owners of more than 5% of certain equity securities are to disclose information relating to such beneficial ownership; and
- U.S. Securities and Exchange Commission – 506(e) disclosure requires issuers to perform due diligence on any person who is going to become a 20% beneficial owner upon completion of a sale of securities.

The EU Takes the Lead

While the EU Fourth AML Directive, which went into force at member-state level in June 2017, was a step forward in beneficial ownership transparency,[22] it did not solve all ills. For instance, the required registers of beneficial ownership of legal persons were not open to full public access, and registration of trusts and other legal arrangements was limited to situations where their activities of such entities generated tax consequences.[23] Disappointingly, some EU member states failed to transpose the Directive into domestic law on time or were not compliant with the Directive's requirements.[24]

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21 https://www.dnb.co.uk/content/dam/english/dnb-solutions

22 https://vinciworks.com/blog/4th-money-laundering-directive-what-you-need-to-know/

23 http://wdm.com.mt/news-events/trusts-in-the-context-of-the-fourth-aml-directive/

24 https://www.taxjustice.net/2018/04/09/the-eus-latest-agreement

In response to the April 2016 Panama Papers, the EU proposed a Fifth AML Directive in July 2016 that entered into force in July 2018. Member states have until January 2020 to enact relevant domestic legislation. Two key enhancements have been made relating to beneficial ownership:[25]

- The general public will have unhindered access to registers of beneficial ownership of legal persons, whereas before, it was necessary to demonstrate a legitimate interest in accessing the information. This restriction remains for access to registers of legal arrangements, although the Directive will apply to all new or pre-existing express trusts irrespective of taxation status; and
- It is obligatory to consult beneficial ownership registers when performing AML/CFT due diligence.

The Fifth Directive is also notable because each member state is required to issue and keep an up-to-date list of persons holding prominent public functions (PEPs), for identification purposes. The EU Commission will then make public an amalgamated list of the national lists, with PEPs at EU level added. This measure will help financial services firms worldwide manage PEP risks more effectively, albeit only in relation to PEPs from EU member states.

Despite these advances, which place the EU considerably ahead of the rest of the world, in particular the United States and Canada,[26] Tax Justice Network expressed some disappointment at the outcome, referring to a number of initiatives that foundered due to opposition.[27] A table summarising the EU beneficial ownership position on LPAs is available at Appendix A.[28]

The UK Addresses Transparency in Tax Havens and at Home

The advocacy group Transparency International has pushed for more stringent beneficial ownership and disclosure rules internationally for many years, through initiatives such as Unmask the Corrupt[29] and reports such as *Ending Secrecy to End Impunity*.[30] In common with Tax Justice Network, it has been strongly critical of the role

25 https://globalcompliancenews.com/eu-5th-anti-money-laundering
26 https://voices.transparency.org/a-new-standard
27 https://sven-giegold.de/lost-and-won
28 Same as 24.
29 https://unmaskthecorrupt.org/
30 https://www.transparency.org/whatwedo/publication/

played by OFCs (aka secrecy jurisdictions) in facilitating financial crime, particularly in relation to corrupt PEPs and tax evasion. Gabriel Zucman has gone as far as describing OFCs as a "scourge" and highlights how the introduction of the EU Savings Tax Directive in 2004 markedly increased the incidence of accounts held in Switzerland by "sham corporations." It is estimated that 8% of global wealth is retained offshore.[31]

Transparency International warmly welcomed the May 2018 vote by the UK Parliament to require the UK's 14 Overseas Territories to establish and maintain public registers of beneficial owners of legal persons. All 14 expressed immediate opposition, with some hinting at a constitutional legal challenge,[32] while the British Virgin Islands described the measure as "colonialism."[33] However, the UK National Crime Agency's criticism of the Cayman Islands[34] would suggest that these reforms are needed, although the Cayman authorities have categorically rejected the criticism.[35]

The UK government has taken a different approach with the Crown Dependencies of Guernsey, the Isle of Man and Jersey, which have been told to put appropriate arrangements in place voluntarily or face further action.[36]

In February 2018, the UK also implemented a requirement for companies and partnerships established in the UK to maintain a register of People with Significant Control (PSC), and to supply that data to Companies House.[37] The fact that over 1,000 UK-registered companies[38] are understood to have been used in the ongoing Danske Bank laundering "giga scandal" shows that abuse of legal persons by criminals is not restricted to OFCs.[39]

Advocacy group OpenOwnership has proposed a single global beneficial ownership registry under the Beneficial Ownership Data Standard [40] and maintains an ownership register that currently lists over 5 million companies from the UK, Denmark, Slovakia,

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31 http://gabriel-zucman.eu/files/Zucman2015Slides.pdf

32 https://www.theguardian.com/us-news/2018/may/02/

33 https://www.bbc.co.uk/news/uk-politics-43965546

34 https://www.bbc.co.uk/news/uk-45525976

35 https://cayman27.ky/2018/09/breaking-premiers-office-hits-back

36 Same as 32.

37 https://www.gov.uk/government/news/. However, the true effectiveness of these measures is unclear, as criminals potentially may take advantage of what is effectively a self-declaration process.

38 Some of them registered in Scotland, an example of dispersal.

39 https://www.reuters.com/article/us-danske-bank-moneylaundering/

40 https://openownership.org/the-beneficial-ownership-data-standard/

Ukraine, and the EITI.[41] Discussions are ongoing with authorities in a number of other jurisdictions, and all EU countries and a handful of countries elsewhere are planning to join by 2020. The UK's action on its Overseas Territories is seen as particularly significant not just in transparency terms (with the hope that their public registers will be added to the OpenOwnership global register), but also in terms of helping to build pressure on jurisdictions that resist joining.[42]

In summary, while heartening progress is being made in a number of jurisdictions, there is still a lot of work to be done, particularly in Canada, the United States, and OFCs.

The Nature and Scale of the Challenge

"Anonymity is a money launderer's best friend"—Dennis Lormel.[43]

International Scandals

For financial services firms, the task of complying with the obligation to understand who they are doing business with can be onerous and complicated. There have been numerous recent scandals involving the use of shell companies to obscure true beneficial ownership of LPAs and assets, such as the Panama Papers,[44] the Paradise Papers,[45] the Bahamas Leaks,[46] the FIFA case,[47] [48] the Petrobras Lava Jato[49] case, and the Danske Bank "giga scandal."[50] The extensive abuse of LPAs by criminals was also confirmed in the World Bank's 2011 Report *The Puppet Masters*,[51] the 2014 *OECD Foreign Bribery Report*,[52] and by the 2018 joint FATF/Egmont Group *Concealment of Beneficial Ownership* Report,[53] which features over 100 case studies.

Collectively, these scandals and reports highlight ongoing weaknesses in the worldwide financial services sector relating to the effectiveness of processes to

41 Extractive Industries Transparency Initiative.
42 https://www.theguardian.com/world/2018/may/02/offshore-secrecy
43 https://www.lexisnexis.com/risk/intl/en/resources/whitepaper/Challenges-of-Beneficial-Ownership.pdf
44 https://www.icij.org/investigations/panama-papers/
45 https://www.icij.org/investigations/paradise-papers/
46 https://www.icij.org/tags/bahamas-leaks/
47 https://www.ft.com/content/b1304de2-51ea-11e7-bfb8-997009366969
48 https://www.justice.gov/opa/file/450211/download
49 https://www.theguardian.com/world/2017/jun/01/brazil-operation-car-wash
50 https://www.reuters.com/article/us-danske-bank-moneylaundering
51 http://documents.worldbank.org/curated/en
52 https://www.oecd-ilibrary.org/docserver/9789264226616-en.pdf?
53 http://www.fatf-gafi.org/media/fatf/documents

establish true beneficial ownership, and in their ability to detect and report abuse of the financial system.

Internal Challenges

A number of internal factors may work in favour of criminals in the financial services sector, such as:

- *Culture* – firms may lack an appropriate compliance culture. The AML/CFT Compliance function may be regarded as a "cost centre" or "business prevention unit" in firms with the most deficient cultures.
- *Expertise* – firms may lack the necessary front line, back office, and technical skills to adequately assess, understand, and manage higher risk scenarios and customer types.
- *Commercial pressures* – firms may pursue more lucrative higher risk customers, without the correct controls and safeguards either being in place or being operated effectively, due to bottom line pressures.
- *Power dynamics* – revenue-generating functions may enjoy greater influence at senior management level than their Compliance counterparts. The result may be that higher-risk business prospects may be pursued and onboarded in spite of concerns, and there may be a willingness to waive or dilute CDD measures in the face of any customer resistance.
- *Silos* – larger firms have different domestic operational divisions (and potentially legal entities), and some have multinational operations. In a purely domestic firm, information and documentation may be kept across multiple computer systems and in multiple physical locations, with little or no coordination or sharing across the whole firm or domestic group. This issue is magnified in firms with multinational operations, and international data sharing may be inhibited by data protection laws. These issues can prevent firms from properly understanding the full nature of the relationship they have with UBOs, leaving them less able to properly understand customer activity and to manage risk. The dream of "big data" still seems beset by challenges.
- *Inadequate or mishandled investment in people and technology* – while numerous annual surveys by consultancy firms confirm year-on-year increases in expenditure on AML/CFT compliance, particularly in developed jurisdictions, it is not clear that this investment is delivering the desired quality of outcome.

While regulators are commonly perceived to focus on technical compliance and evidencing paper trails, law enforcement focuses on quality STRs that can lead to criminal convictions. These should not be mutually exclusive, but firms are more likely to focus on technical compliance due to the tendency of regulators to punish poor technical compliance rather than poor STRs. From an IT perspective, core systems may be antiquated and lack the capacity to capture key CDD data required by evolving regulations, and prohibitive system update costs often lead to inefficient alternative measures, such as spreadsheets or databases that cannot necessarily be connected to or integrated with other systems. The effective implementation and calibration of transaction monitoring systems is a notoriously expensive and difficult task, with the key challenge being to legitimately reduce the false positive ratio of ML/TF alerts while optimising the conversion ratio of alerts to STRs.[54] While transaction monitoring software has become more common in developing jurisdictions, a lack of appropriately experienced and skilled IT and AML/CFT human resources is an impediment to successful system implementation and calibration.

- *Complexity* – the task of understanding who is the UBO is significantly complicated by complex ownership trails that can cross geographical, legal, and linguistic boundaries. Criminals exploit these complexities to obscure the real identities of the person or persons who ultimately benefit from financial transactions.

External Challenges

External factors that impact firms include:

- *Regulatory complexity* – the lack of a consistent definition of UBO and different thresholds of ownership used under different regulatory regimes.
- *Access to information* – the absence of beneficial ownership registers, although this is being addressed to some extent, as discussed earlier in this paper. Significant differences will remain between jurisdictions, however, allowing criminals to target jurisdictions with weaker or absent requirements on the

54 My own observations are that the conversion ratio of ML/TF alerts to STRs can be as low as 2 to 2.5%, with 5 to 7% being considered a good outcome. A 93% inefficiency rate would likely be considered unacceptable for processes in other walks of life.

disclosure of beneficial ownership. This trend has recently been confirmed by the UK's National Crime Agency.[55]

- *Cost* – existing restricted information available on the beneficial ownership of LPAs is often difficult and expensive to access, and there is no guarantee that the limited information available is accurate and up-to-date.
- *Cooperation* – legislation may inhibit or does not explicitly allow cooperation and exchange of information between firms for AML/CFT purposes, leading them to take a "safety first" approach that gives an advantage to criminals.
- *Technology* – "Fintech," such as new payment services, mobile banking, simplified electronic cross-border money remittances, cryptocurrencies, automated performance of an agreement using block chain technology, and peer-to-peer financing platforms offer new opportunities for criminals to obscure their identity when conducting transactions. However, innovation in "Regtech" is not keeping pace with Fintech.[56]
- *The criminal toolkit* – techniques used by criminals to frustrate compliance processes and obscure beneficial ownership identified by FATF[57] include: shell companies; bearer shares and bearer share warrants; unwarranted complexity in ownership and control structures; legal persons acting as directors; both formal and informal nominee shareholders and directors, making true beneficial ownership opaque; the separation of legal and beneficial ownership of assets through the use of trusts and other legal arrangements; falsifying activities such as sham loans, false invoices, and misleading naming conventions; and unscrupulous or lax "gatekeepers."[58]

The Scale of the Problem

Due to its covert nature, it is impossible to establish a definitive estimate of the scale of money laundering in the global economy. While the long-standing United Nations' estimate of 2%–5% of global annual GDP is considered reasonable, there are no estimates for the scale of laundering specifically using LPAs. However, advocacy

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55 https://www.bbc.co.uk/news/uk-45525976

56 Same as 1 (page 38 of the source document).

57 http://www.fatf-gafi.org/media/fatf/documents/reports

58 http://www.fatf-gafi.org/media/fatf/documents/Professional-Money-Laundering.pdf. Gatekeepers were also recently criticised by UK law enforcement for failing to submit STRs on transactions that were reported by involved banks https://www.theguardian.com/uk-news/2018/sep/14/uk-lawyers-failing-report-suspected-money-laundering-national-crime-agency

group Global Financial Integrity estimated in 2013 that illicit financial flows from developing countries alone were US$1.1 trillion.[59]

An Audit Programme for AML/CFT Compliance, Including Beneficial Ownership

The best practice recommendations below may be used as part of an audit programme to assess the effectiveness of AML/CFT compliance frameworks, including requirements relating to beneficial ownership of LPAs:

Compliance Culture

- Is there evidence of a strong and clear "tone from the top"?
- Is there a clear risk appetite statement or policy, and is it followed in practice?
- Is there evidence of senior management[60] engaging with and taking responsibility for AML/CFT issues, including the overall effectiveness of the control framework?
- Is there evidence of senior management approval of the onboarding of PEPs and other high-risk customer types, including complex corporate structures?
- Is there evidence of senior management consistently or frequently overriding the views or warnings of the AML/CFT Compliance function on customer risk issues?
- Does the disciplinary policy include measures relating to wilful or negligent staff non-compliance with the AML/CFT requirements? Is there any evidence that the disciplinary policy has been invoked where there was reasonable cause to do so?

Internal CDD Policies and Procedures

- Do they exist?
- Do they accurately reflect the legal and regulatory requirements?
- Have they been regularly updated, including in response to ad hoc legal or regulatory changes?

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59 https://www.gfintegrity.org/issue/illicit-financial-flows/

60 The Board of Directors and senior-level executives.

- Are the requirements relating to identification and verification of UBOs specified for each line of business, product or service type, and LPA customer type?
- Do they include provisions for exemptions, overrides, or deferrals, and if so, are appropriate control mechanisms in place to record the reason for exemptions or overrides, and to pursue deferrals to proper closure? Is there evidence that the control mechanisms are being properly operated? Are there clear roles and responsibilities in the process for proposing, approving, tracking, closing, and reporting?
- Is there a clear position to refuse business where the CDD requirements have not been met, including those relating to the identification and verification of UBOs? Is there an obligation to submit an internal STR, or to consider the submission of an internal STR, in such circumstances? If so, have these resulted in external STRs?
- Have they been approved by senior management?
- Are they actively being applied at the operational level?
- Are they risk-based, with appropriate standards for different risk levels?
- Is the customer risk rating methodology fit for purpose and properly implemented?

Onboarding and Relationship Continuation

- Is there a clear process for the approval of new relationships, and is it being followed correctly?
- Is there a clear process for the approval of the renewal or continuation of existing relationships, where applicable, and is it being followed correctly?
- Is the approver at an appropriate level of seniority and experience to properly undertake the responsibility?
- Is there physical evidence of approvals, either in paper or electronic form? Are the approvals consistently on file/accessible?
- Is there evidence of escalation of complex or high-risk cases to senior management and the AML/CFT Compliance function?
- Is there evidence that appropriate customer screening has been executed prior to customer acceptance, including sanctions, background, and adverse media screening?

- Are the requirements relating to the identification and verification of UBOs being consistently met?
- Are higher-risk customers consistently identified as such, and appropriate CDD procedures applied accordingly?
- Is there evidence of an unacceptably high level of irregularities/non-compliance with internal policies and procedures?
- Is there evidence of the use of exemptions, overrides, or deferrals, and if so, is it with an unusually high frequency? Is there a pattern of involvement in terms of staff members, branches or departments, managers, or individuals or firms who are gatekeepers introducing business to the firm? Are deferrals successfully closed out, or do they stay open indefinitely without receiving further scrutiny?
- Is there evidence of the customer CDD profile being reassessed on a cycle relevant to the relationship risk rating or in response to trigger events? Are trigger events appropriately defined and enforced?

Monitoring and Reporting

- Is there evidence of appropriate ongoing staff scrutiny and monitoring of customer behaviours and transactions, including relating to changes to the customer CDD profile, directors, shareholders, etc.?
- Is there evidence that unusual behaviours and transactions are properly considered and escalated within departments where appropriate?
- Are suspicions reported to the MLRO via an internal STR?
- Is there any evidence to suggest suppression of reporting of suspicions?
- Is there evidence that the MLRO appropriately considered internal STRs, and submitted external STRs where required?

Ongoing Assurance and Monitoring

- Is there evidence of real-time or after-the-fact assurance/quality checking of onboarding and relationship renewal or continuation cases?
- Is there evidence of real-time or after-the-fact assurance/quality checking of CDD deferral cases, if any?
- Is the sample size adequate, and the sampling methodology appropriate?

- Is the checking effective in identifying technical and procedural anomalies?
- Are identified anomalies remediated within a reasonable time period?
- Is there an identifiable pattern or trend in the nature of anomalies?
- Are anomalies flagged to department management, and if serious in nature, escalated to senior management?

AML/CFT Training

- Can staff demonstrate awareness of the CDD responsibilities applicable to their role?
- When did they last receive training, either classroom-style, e-learning, or on-the-job, relating to CDD and beneficial ownership?
- Are the training materials accurate and compliant with legal and regulatory requirements? Is there evidence of a change management process for the materials, including a formal review by the Legal function?
- Are there separate induction and ongoing training materials?
- Is there evidence that training materials are regularly reviewed and updated, including in response to ad hoc legal or regulatory changes?
- Are new joiners prohibited from carrying out their job roles until they have received AML/CFT training, where such roles carry a risk of ML/TF? If untrained new joiners can carry out some or all of their job functions, are they subject to appropriate controls or limitations, such as their work product must be approved by a suitably experienced, senior, trained person?
- Is there a test of understanding following the training?
- Are training records available showing attendance and test grading?
- Is attendance at training less than 100% without an adequate reason, e.g., employee left the firm, maternity leave, long-term sickness, etc.?
- Has management, including senior management, received appropriate training?
- Is there evidence of robust follow-up with management where staff members repeatedly fail to attend training, or repeatedly fail the test of understanding?

Management Information

- Is there regular MI reporting to senior management, including on CDD compliance standards?[61]
- Is there evidence of appropriate management action in response to evidence of unsatisfactory CDD standards and anomalies?

Specific Issues to Consider Relating to Beneficial Ownership of LPAs

- Have any normal processes been waived or deferred in the face of customer resistance or refusal to cooperate? Was it approved by senior management? Was enhanced monitoring applied to the customer as a result?
- Have both credit and debit transactions been allowed to take place before the completion of the CDD requirements? Was this recognised and appropriately investigated? Was this because appropriate controls were not in place, or because the controls failed? Was there an appropriate outcome, such as termination of the relationship, suspension of the relationship pending regularisation, submission/consideration of the submission of an internal STR, and the submission of an external STR?
- Has the correct risk rating been applied to the customer, and have the resulting CDD processes, including those relating to identification and verification of UBOs and other parties to the relationship, been appropriately applied?
- Has the appropriate beneficial ownership threshold been applied? (See earlier comments about different regulatory regime thresholds.)
- Has "lifting the corporate veil"[62] been executed properly, with all layers of ownership revealed until natural persons are reached?
- Have all natural persons who are party to the relationship or transaction been appropriately identified and, if required, verified? In the case of legal persons, this would include settlors, trustees, the protector (if any), the beneficiaries (including every beneficiary that falls within a

61 In recognition of the elevated ML/TF risk, Consideration may be given to separate MI specifically on LPAs, or the highest risk LPAs.

62 Sometimes referred to as "unwrapping" by industry practitioners.

designated class), and any natural person exercising ultimate ownership, ultimate control, or ultimate effective control over the trust (including through a chain of control or ownership, or through a power of attorney).

- Have appropriate, reliable, government-issued identity documents been obtained when verifying evidence of identity?
- Where there has been no face-to-face contact with the customer, has this been recognised in the risk-rating calculation? Have ID documents been appropriately certified?
- Has the relationship between all UBOs been properly considered?
- Is there reason to think that the UBOs may be linked in some way, e.g., spouses, family members, close associates, or friends? Be aware that in some cultures, directly related family members may have different family names, and that family names change due to, for instance, marriage.
- If linkages are suspected or confirmed (acting in concert), and the collective shareholding of the linked natural persons exceeds 25%, have those persons been subjected to the verification of identity process?
- Has the possibility of straw men or proxies been evidently considered? Indicators could be that the purported beneficial owners or controllers do not have the level of expected understanding and knowledge about the structure, business, or activities of the LPA, and cannot provide explanations or context about them to a reasonable level of detail without delays and reference to other parties.
- Have any persons acting as nominees been identified and treated as nominees?
- Has indirect, as well as direct, ownership been considered, and, where applicable, accurately calculated with verification of identity appropriately carried out?
- Where there are natural persons exercising control who are not shareholders, have those persons been subject to the identification and verification requirements?
- If the customer ownership structure is complex, has the reason for the structure been explained? Is the explanation plausible and reasonable,

especially if any legal persons have been incorporated in multiple different and/or high risk jurisdictions, particularly those known for lax AML/CFT standards and minimal corporate disclosure requirements? (Be aware of jurisdictions identified by FATF or other competent bodies as high risk, deficient, or non-cooperative.)

- Where the customer is a trust or other legal arrangement, are the risks associated with the specific type of legal arrangement understood, as well as the applicable rules in the jurisdiction in which the legal arrangement was established?
- Have any powers of attorney been issued, and has the reason for them been ascertained and considered reasonable? Have the identification and verification requirements been applied to the attorney?
- Are any persons in the structure a foreign or domestic PEP (which includes being a relative or a close associate of a PEP, or an entity owned or controlled by a PEP)? If so, has enhanced due diligence been applied? Has the relationship received senior management approval?
- Do any legal persons in the structure issue bearer shares? Have the bearer shares been immobilised or registered?
- Have the nationality and country of residence of all natural persons in the structure been ascertained? Do any of them present a higher risk for any reason, and was the risk rating adjusted accordingly?
- Has it been ascertained whether any of the natural persons hold dual citizenship, with one jurisdiction representing higher risk than the other, but only the lower risk citizenship is initially disclosed? (This is a known typology in both money laundering and international financial sanctions evasion, and may lead to the allocation of a lower customer risk rating than is appropriate, or a possible sanctions issue or breach).
- Has the nature of the customer's business activities and intended transactions been ascertained, and the correct risk rating allocated?
- Do the jurisdictions of incorporation of each of the legal persons in the structure present a higher risk for any reason?
- Has the source of funds for each legal person, and the source of wealth of each natural person, been verified in accordance with the risk-based approach?

- Has an adverse media check been conducted on all legal persons and natural persons in the structure, including connections to persons subject to local or international financial sanctions requirements?
- Has verification of identity been re-performed at other stages of the customer life cycle other than at onboarding, such as where an official identification document has expired, where there is suspicion of ML/TF, where there are doubts about the veracity or adequacy of previously obtained customer identification data or documents, or where such documentation has expired?
- If there has been a change to the activity of the customer or its transactions, or a change to the structure, control or ownership, has appropriate due diligence been carried out, including identification, and verification where required, of the parties to the relationship?
- Are all relevant records available, either in soft or hard copy, without any delay in retrieval?

Summary/Conclusions

"If you think compliance is expensive, try non-compliance"—Paul McNulty.[63]

Financial services firms play a key role in the global economy, but also a key role in global financial crime.

International problems require international solutions, but while international initiatives head gradually towards greater transparency of beneficial ownership and reducing the currently significant variations in standards and practices across jurisdictions, it is unclear to what extent these measures will ultimately frustrate criminal activity or increase interdiction rates of criminal funds.

The history of professional money laundering is that of innovation in the face of adversity and the exploitation of new markets and opportunities. Laundering activity therefore tends to be displaced rather than curtailed, with launderers targeting the path of least resistance, i.e. those jurisdictions with the weakest AML/CFT environments.

63 http://www.compliancebuilding.com/2009/06/04/mcnulty

The global implementation of new international initiatives is a slow process, and the quality and speed of outcomes across jurisdictions are never uniform. This leaves open ongoing opportunities for jurisdictional arbitrage. Firms in all markets therefore must be particularly vigilant about properly establishing ultimate beneficial ownership when conducting due diligence on legal persons and legal arrangements, no matter the jurisdiction of incorporation or establishment. Flows of criminal funds do not recognise borders.

Firms must also continue to focus on key risks and vulnerabilities, on investment in people and technology, and on producing high-quality STRs, while ensuring policy and process rigour to protect themselves against abuse of their products and services by criminals, and also against the increased risk of regulatory criticism and sanctions, including financial penalties.

Record fines have been levied against numerous banks and other financial institutions in the last decade for AML/CFT breaches. However, as illustrated by the recent cases involving Commonwealth Bank of Australia[64] (US$530 million) and Deutsche Bank[65] (US$700 million), the financial penalty payable to the regulator is normally the tip of the iceberg. There are significant additional hidden costs, such as initial and ongoing expenditure on increased or enhanced systems, policies and procedures, processes, technology, and human resources to address the identified failings.

However, it may be overlooked that AML/CFT non-compliance also imposes an involuntary opportunity cost on a financial institution. The situation requires that a disproportionate amount of management time be spent on dealing with the regulator (and/or an independent monitor imposed by the regulator[66]) and all matters arising from the breach. Even where a firm is not subject to any new business or other activity restrictions from the regulator, senior management is less able to spend time on new products, initiatives, and innovations that could drive the business forwards.

However, if this is not sufficient incentive for senior management, the Danske Bank "giga scandal" case (where global penalties are expected to be billions of U.S. dollars[67]), and the ING case (US$900 million penalty) have been career-ending

64 https://www.moneylaunderingwatchblog.com/2018/06/
65 https://www.reuters.com/article/us-deutsche-bank
66 https://www.bafin.de/SharedDocs/
67 https://www.theguardian.com/business/2018/sep/20/danske-bank

events[68] [69] for senior executives[70] at both institutions, and have resulted in a severe market[71], customer[72] [73], political[74], and legal[75] and regulatory[76] backlash. In the case of ABLV Bank in Latvia, AML/CFT breaches ultimately led to its collapse and closure.[77]

Good AML/CFT compliance can therefore be seen as sensible and sound practice from a number of perspectives.

68 https://www.moneylaunderingwatchblog.com/2018/09/danske-bank

69 https://www.bloomberg.com/news/articles/2018-09-11/ing-cfo

70 Perhaps the ultimate "wake up call" globally would be the prosecution and imprisonment of senior executives.

71 Danske Bank's share price has declined by more than 30%. https://www.bloomberg.com/news/articles

72 Business closes account at Danske Bank due to money laundering scandal. https://www.pymnts.com/bank-regulation/2018

73 Charity closes account at Danske Bank, and other charities and local government account holders consider account closure. https://www.reuters.com/article/us-danske-bank

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Appendix A

	Company/Legal Entity	Trusts	Legal Source: current 4th or proposed amendment for the 5th EU AML Directive
Triggers for Beneficial Ownership Registration			
It's incorporated, created or governed by the laws of an EU country	✓	✗	Companies: Art. 30 (current and proposed)
It's managed/administered in the EU	✗	✓	Trusts: Art. 31 (proposed)
It enters into a business relationship or acquires real estate in the EU	✗	✓	Trusts: Art. 31 (proposed)
Any of its parties (e.g. shareholder, settlor, protector, beneficiary, etc.), other than the manager, administrator or trustee, is resident in the EU	✗	✗	-
Access to Beneficial Ownership information			
Authorities, obliged entities	✓	✓	Companies: Art. 30.5 (current and proposed); Trusts: Art. 31.3 (current and proposed)
People/organisations with a legitimate interest	(✓)	✓	Companies: this would be covered by the proposed public access, see below (current Art. 30.5 of the 4th AML Directive includes legitimate interest); Trusts: Art. 31.4.c (proposed)
People/organisations related to a non-EU company that is owned by a company/trust subject to beneficial ownership registration	(✓)	✓	Companies: this would be covered by the proposed public access, see below; Trusts: Art. 31.4.d (proposed)
The general public	✓	✗	Companies: Art. 30.5 (proposed)
Type of Access to Beneficial Ownership information			
Subject to online registration and fee	✓	✓	Companies: Art. 30.5a (proposed); Trusts: Art. 31.4a (proposed)
Online	✗	✗	-
Free	✗	✗	-
Open Data format	✗	✗	-

Source: https://www.taxjustice.net/2018/04/09/the-eus-latest-agreement