White Paper

Ultimate Beneficial Ownership – The Implications of Not Knowing

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Author: Ana Maria H. de Alba

Beneficial ownership has taken center stage in compliance matters, spanning from FCPA compliance to AML/CFT and even FATCA compliance. The 2012 face-lift of the FATF-GAFI 40 Recommendations made it very clear that among the essential measures expected of countries to have in place in their AML/CFT regimes is "transparency and availability of beneficial ownership information of legal persons and arrangements." Thus, considering that the FATF-GAFI is tasked, among other things, with measuring the level of commitment and compliance with the 40 Recommendations, and will call jurisdictions to action against those that do not meet minimum standards, it is safe to assume that the implications of not knowing who we are "ultimately" doing business with, may be severe.

Beneficial Ownership is addressed in various manners by the FATF-GAFI; for example, Recommendation 10, which addresses the Customer Due Diligence (CDD) measures that are expected from financial institutions, specifically states that "Identifying the beneficial owner, and taking reasonable measures to verify the identity of the beneficial owner, such that the financial institution is satisfied that it knows who the beneficial owner is. For legal persons and arrangements this should include financial institutions understanding the **ownership and control structure** of the customer." This is particularly important because this Recommendation also states "Financial institutions should be required to **verify the identity** of the customer and beneficial owner **before or during the course of establishing a business relationship or conducting transactions for occasional customers**."

Now, the definition of beneficial owner, within the context of customer identity as stated above, differs from that of the ultimate beneficiary of say, an insurance policy or investment such as a time deposit or savings account, or even a trust arrangement. In these cases, the verification of identity would need to take place when such beneficiary claims or is due the funds or assets "in their benefit". Notably, in insurance and trust arrangements, often times the beneficiaries are minors or even persons who have not even been born, making it irrelevant or even impossible for a financial institution to identify said beneficiary. The fact is that for compliance matters, the main objective of knowing and identifying the beneficial owner is to know who **owns or is in control** of the assets or funds, and not the person who is **entitled to the benefit** of say a trust or an insurance policy, noting that the person who is "entitled to the benefit" will only have access or control of those funds when an event (i.e. such as death) occurs, but prior to that, the person is merely the beneficiary of a future event.

Identifying beneficial ownership has been a difficult task, if not impossible, until very recently. Standard practice has been for clients to make investments using legal arrangements (i.e. a limited liability company, or offshore company, etc.) in order to shield the name of the "natural persons" who are the ultimate beneficial owners of the investments. And this brings us to the definition of "beneficial owner".

Various agencies and supranational bodies have defined the term beneficial owner, but for the most part, they all agree with the FATF definition, which refers to "the natural person(s) who ultimately owns or controls a customer and/or the natural person on whose behalf a transaction is being conducted. It also includes those persons who exercise **ultimate effective control** over a legal person or arrangement."

So far, the first portion of the definition has not been too much of an issue for financial institutions, given that even the most simplified form of customer due diligence will require the full identification of a trustee or attorney-in-fact. For example, in cases where an individual establishes a new relationship and subsequently grants power of attorney to another person to move funds and manage the relationship, a standard practice and legal requirement in many jurisdictions calls for full identification and identity verification procedures on that person (the "attorney-in-fact").

However, knowing and identifying the natural persons who exercise ultimate effective control may be a bit more difficult or at a minimum, more cumbersome to accomplish. Let's take for instance a simple example, where a corporation seeks the financial services of an entity to establish an investment account or an operating account. Often times corporations have several layers of ownership, which may be created to protect the names of natural persons who "ultimately" own the organization from undue liabilities (i.e. legal, tax, etc.) or for other reasons, all of which may be perfectly legal. Some of these legal arrangements are very complicated in structure, more so when they are specifically designed to protect the name of those "natural persons"; also some governments boast their secrecy laws as an attractive incentive to incorporate legal arrangements in their jurisdiction. Individuals who whish to protect their name from undue liabilities (real or perceived) are their main target.

So now we have a natural person wishing and willing to shield their name behind a legal arrangement and a jurisdiction willing to assist him or her. To meet its "secrecy" or "privacy" goal, the jurisdiction must not allow public access to a register of the companies, and it may even allow the issuance of bearer shares. Generally, these records are kept with the attorneys who assist in the process of incorporation, and information concerning the parties to the transaction could remain under privileged and confidential attorney-client-work product. An interesting twist is that a natural person does not have to provide a reason as to "why" they seek to protect themselves behind a corporate name, thus making these legal arrangements a very attractive vehicle for criminal element to also use them to "shield" their names as the natural persons who exercise ultimate effective control of the corporation and of the accounts and assets which that corporation will ultimately own.

In the United States, beneficial ownership identification has been a requirement since the enactment of the USA Patriot Act; however it only applies to foreign entities and foreign individuals seeking to establish a relationship at a financial institution in the USA. Within that context, identifying the ultimate beneficial owner of an account holder meets the enhanced due diligence requirements both under the USA Patriot Act and FATF-GAFI Recommendations, yet these requirements do not apply to domestic entities (legal and natural). It is clear then that identifying ultimate beneficial ownership (UBO) is a risk mitigating factor that serves to "know" who an entity is actually dealing with, thus making it possible to fully comply with verification against special lists (i.e. OFAC, United Nations, etc.) and also identifying Politically Exposed Persons (PEP). Notwithstanding, many countries, in choosing to apply a risk based approach to their implementing regulations, excluded their citizens and domestic legal arrangements from having to disclose the UBO. That changed when the FATF-GAFI in 2012 provided greater guidance on transparency and ultimate beneficial ownership through Recommendations 10, 22, 24 and 25.

In response to these Recommendations, a recent "proposed rule" announced by FinCEN in the USA calls for financial institutions to identify the UBO on domestic legal arrangements. In this case, the rule is suggesting identifying anyone who owns or controls 25% or more of a legal arrangement; however this threshold will be considered as the minimum standard, and it does not preclude a regulated entity from applying a lower threshold. In fact, it is likely that many organizations will apply the 10% threshold to meet FATCA requirements. The rule is not final yet, but it appears that few changes, if any, will be made to the proposed rule.

Obviously, the global financial community has been placed under pressure to meet FATF-GAFI Recommendations, and it is only natural that a greater effort will be made by each jurisdiction to make information public so as to support the compliance efforts of its financial services industry. However, this will not happen overnight and financial institutions are already expected to meet or comply with the Recommendations. Furthermore, to meet their regulatory obligations, many institutions have implemented internal procedures that call for navigating through a multitude of Internet pages, creating often times a cumbersome, frustrating, and time-consuming task that may or may not yield fruitful results.

Here are some tips that may be helpful in achieving your organization's compliance goals:

1. Require customers to provide UBO information and offer to keep details of identification and information under special custody (this could be a fee generating service)
2. Require customers to provide the names of the natural persons that are UBO of legal persons or arrangements that own more than 10% of the shares of the entity
3. Where there are other entities listed as UBO, inquire about the purpose of single and/or multiple layers of corporate names to better understand the reason for that protection
4. Educate customers on the reasons why your organization needs the information concerning UBO and how that benefits the client (i.e. to better serve them, compliance objectives and obligations of the organization, etc.)
5. Require customers (especially those rated "high-risk") to provide updated information about changes in substantial ownership (following jurisdictional percentage requirements – i.e. 25%, 10%, etc.) whenever there is a change in ownership and at least annually
6. Require customers to provide certificates of ownership as evidence of ownership and maintain said certificates under custodial services, especially for bearer shares
7. For expedited access, bookmark online pages for corporate registries provided by government agencies in order to corroborate information provided by customer
8. Consider using advanced tools, such as database solutions used to screen against special lists, and verify if names provided by customers appear on PEP lists or other enforcement lists (these tools may provide affiliated names and adverse media references that are helpful in identifying additional UBO)
9. On more difficult cases of UBO identification, consider outsourcing intelligence services that can provide enhanced due diligence information that is not publicly available

In summary, the compliance goal is to meet regulatory obligations, yet the ultimate goal and benefit of any organization is to have solid knowledge of its customer base so that marketing efforts are directed to the appropriate clientele, and controls are placed where they are most needed; this is in essence the risk based approach and benefit to knowing our customers.

Multiple implications surround the not knowing the UBO of a legal person or arrangement doing business with our organization. Among those, an organization will risk infringement of the law and international standards, and will place its reputation at risk, all of which translates into hefty fines and loss of revenues. Particularly, as we have seen in recent cases, a jurisdiction that resists transparency risks placing its financial system into isolation from the global financial community, and banks that choose to ignore the requisite of identifying the UBO may end up processing transactions in violation of UN Sanctions, FCPA, UK Bribery Act, OFAC, and even Section 311 of the USA Patriot Act. In these situations, losses cannot be quantified at the cost of a fine, but rather at, among others:

- The loss of opportunities and their related revenues
- Loss of morale from the most important asset of the organization – its human resources- which will undoubtedly reflect in lower performance and quality of output
- Replacement cost – new hires, new systems and procedures (very likely at increased costs due to situation and urgency for corrective actions)
- Future ability to establish new banking relationships

The primary benefit of knowing who the "natural person" that is the UBO of any relationship with an organization is that it will enhanced that organization's ability to comply with regulatory obligations such as identifying PEP and individuals listed in special lists. It will also allow the organization to identify those individuals that may have been previously flagged by the organization as "prohibited", and equally important, it will enhance the organization's ability to learn about the level of wealth or potential of the individual(s) behind a corporation in order to build better, stronger, and longer lasting relationships.

About the author

Ana Maria H. de Alba is the President & CEO of CSMB, a risk management and banking consultancy headquartered in Miami, Florida and offices in Panama, Republic of Panama. Her experience spans more than 28 years in the financial services and consulting industries leading projects in financial crime investigations, risk and risk mitigation, due diligence in support of mergers and acquisitions, and independent evaluations of internal controls, as well as a broad range of employee and Board of Director training. As a former senior banking officer, Ms. de Alba worked in both domestic and international banking. As a consultant she has led and participated in multiple engagements, providing her services to internationally recognized business intelligence and security firms, in a wide range of business sectors that include the financial services industry as well as government entities throughout the USA, Latin America, and the Caribbean. Ms. de Alba is a recognized and frequent speaker at numerous international conferences, where she has exposed on issues related to risk mitigation and internal controls.

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