

How to Identify Beneficial Ownership in a Not-so-transparent World



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INTRODUCTION

Beneficial ownership transparency is in the spotlight, and many compliance experts believe 2017 was a turning point in achieving greater transparency at a global scale, especially in preventing tax evasion and corruption. Recent regulatory efforts of government and international agencies, such as the US FinCEN CDD final rule and the G20 Anti-Corruption Action Plan, have been aimed squarely at strengthening beneficial ownership transparency rules.

However, the limited accessibility, reliability and timeliness of beneficial ownership data on legal persons and legal arrangements are still the bottleneck preventing many businesses from effectively mitigating credit risks and compliance risks related to financial crimes such as corruption, tax evasion, and money laundering.

While it may take a longer time to realize full beneficial ownership transparency worldwide, it is important that regulated firms have a full grasp of the beneficial ownership due diligence-associated risks in the countries in which they conduct business. That knowledge will enable them to take a risk-based approach, leveraging the best available data and adopting measures to augment today's beneficial ownership due diligence processes. The ultimate goal is not just to be compliant with the minimum regulatory requirements, but to prevent the business from significant risks.



WORLDWIDE BENEFICIAL OWNERSHIP TRANSPARENCY EFFORTS

Regulatory efforts have ramped up in the past few years, and accelerated further in 2017, as government and international agencies sought to strengthen beneficial ownership transparency rules.

EFFORT	PROPONENT	DATE INTRODUCED
Companies (Amendment) Bill 2017	Hong Kong	January 2018
Counter-Terrorism and Illicit Finance Act	US House of Representatives	November 2017
Corporate Transparency Act of 2017 – Introduced by Senators Marco Rubio and Ron Wyden	US Senate	August 2017
Report to G20	Financial Action Task Force (FATF)	July 2017
Companion Bill to Corporate Transparency Act of 2017	House of Representatives	June 2017
Crown Dependencies and British Overseas Territories treaties	UK Territories	April 2017
Beneficial Ownership Rules (as part of the proposed 5th EU Anti-Money Laundering Directive)	EU Parliament's Economic & Monetary Affairs & Civil Liberties committees	February 2017
G20 Anti-Corruption Action Plan 2017-2018	G20	2017
Company Act Amendments	Hong Kong, Singapore & Taiwan	2017
Federal Law No. 215-FZ Amendments	Russia	June 2016
FinCEN CDD Final Rule	FinCEN	May 2016
Persons with Significant Control (PSC) Register adoption	Denmark, Norway	April 2016
Normative Instruction No. 1.634/2016	Brazil	2016
New Company Bill	Malaysia	2015
Company Act	India	2013

THE CHALLENGE OF TRANSPARENCY

As the Financial Action Task Force (FATF) report to G20 points out, only a handful of countries to date have collected beneficial ownership data and made the data available to the public. For the rest of FATF's 200+ jurisdictions and regions to implement beneficial ownership standards and share the data domestically or even across jurisdictions, there are many hurdles to overcome. It could take years. Let's look at three distinct challenges, along with recommendations to begin to solve them.

Centralizing beneficial ownership data is a complex decision.

The ownership disclosures for individuals and business entities are governed by local jurisdictions, each with varying legislative processes. Any changes typically need to go through formal legislative amendments, and it can take years from initial proposal until it becomes a law. For example, New Zealand introduced the Companies and Limited Partnerships Amendment bill in 2011. By 2014, the bill had its third reading in the House, and it is still pending.

The division of power between various branches of the government can also be a hurdle, as federal and local government bodies are sometimes at odds. For instance, in the United States, legal entity formation and data sharing within state governments varies by geography, and few states require naming beneficial owners at the time of corporate formation. In addition, state registries are not consistent with the Extractive Industries Transparency Initiative (EITI) standard – a global standard for the good governance of oil, gas and mineral resources. And only a few states make incorporation data accessible to the public through online systems; they include Ala., Conn., Mass., Neb., NC, Tex., and Va. Company secrecy at the state level benefits those governments by attracting investment, along with increased employment and additional tax dollars. The June 28 proposed bill in the US House of Representatives by Rep. Carolyn Maloney, designed to tackle money laundering, is the fifth attempt at passing the measure. Historically, the bill has failed because of opposition from trade organizations.

Tax haven jurisdictions have a similar dilemma because they are being pushed for more transparency, but at the same time they are trying to foster business-friendly registration processes. In some tax havens, such as

Switzerland and Luxembourg, maintaining investors' secrecy has not only been a long-standing tradition, but also contributes to the stability of local banking systems. This might be the reason that Luxembourg lags behind other EU countries on Beneficial Ownership progress. As a non-EU member state, Switzerland is not subject to the EU AML Directive, so it has less pressure to create a UBO register. It took years for Switzerland to agree to share bank info with the UK, the US, and other jurisdictions. It would likely be a long journey for the Swiss to add beneficial ownership transparency. In British Overseas Territories (OT) and Crown Dependencies (CD) such as Cayman Islands, The British Virgin Islands, and The Bahamas, being a tax haven is the "royal tradition," based on British rule and is often the most important source of government revenue.

In the debate surrounding the UK's public register of Persons of Significant Control recently, the OTs and CDs successfully negotiated an agreement to maintain a private and confidential ownership database and self-defined process and timeline. Additionally, for many countries, building a centralized register to house beneficial ownership data is a significant expenditure. It requires initial financial investment, people, and technology for planning and implementation and requires continuous investment to run and maintain it. These are especially challenging for under-developed and war-torn countries, such as The Democratic Republic of Congo, Syria, and Zimbabwe. When countries are fighting terrorists, hunger, and poverty, transparency is not a priority.

While it's not an easy decision to centralize beneficial ownership at a national level, it is critically important and will generate significant positive impact on domestic economic health and on the country's international reputation.

RECOMMENDATIONS

For regulated firms, the best way to move toward a more centralized approach is to:

- Stay on top of the progress countries have made.
- Include transparency risk into any existing country risk assessment you perform.
- Review your enhanced due diligence rule to cover any high-risk scenarios in not-so-transparent nations.

Quality of self-reported beneficial ownership data is a concern.

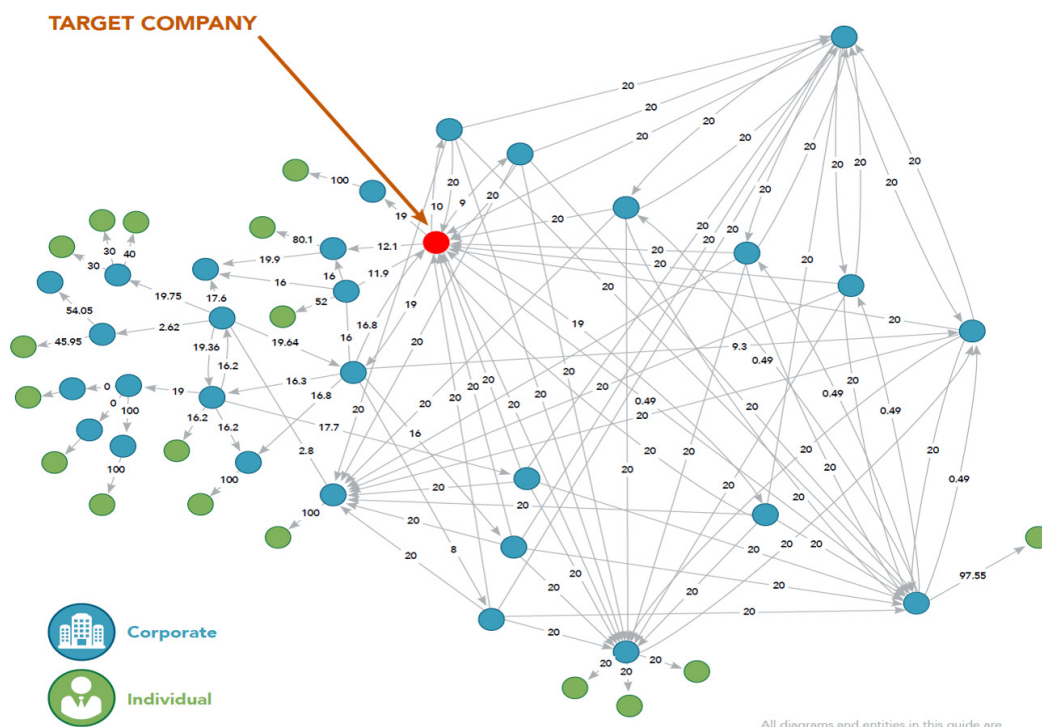
There are several dimensions to measuring beneficial ownership data quality, which include data accuracy, data freshness, and data completeness. Even among the countries that are dedicated to a centralized beneficial ownership registry, there is no single standard implemented among them.

Whether the beneficial ownership data is collected by the register or by regulated firms, the data quality is highly dependent on legal persons or their representatives' self-disclosure, which is further subject to:

- **How transparent the legal person is.** If the legal person is used as a corporate vehicle to hide a company's real ownership, the self-disclosed ownership data may be intentionally misleading or inaccurate.
- **How well the representative/entity management knows their upper level entities and owners.** In many corporate structures, the ownership calculation will not be straightforward. For example, in the illustration below, the target company is shown as part of a complex corporate structure. The representative at this target company may be able to identify the direct owners and one or two layers of indirect owners, likely, but they may not understand

how other indirect owners – who may own part of the company – are mapped. In this case, even the representative willing to disclose to full knowledge may contribute invalid data.

- **The penalty – or lack of penalty – associated with inaccurate disclosure and delayed reporting of ownership changes can lull businesses into complacency.** Companies are often not subject to sanctions for failing to provide accurate and up-to-date ownership data as required. It can be difficult to assess penalties because no indications are provided on the sanctions policy that is applicable when requirements are not complied with. One possible remedy is the introduction of a new US Senate bill regarding concealment of the ultimate beneficial owner of an account. However, even if legislation is amended to penalize concealment, it still remains challenging for firms to detect and investigate these errors without using outside data.
- **Human error.** Self-reported information, while it may be accurate, can simply be wrong based on human error, such as typos, inaccurate numbers, and omitted information.



– Verification of the beneficial ownership data

collected. Most countries with beneficial ownership registries currently have no legislative requirement to verify the accuracy of information provided. Without verification at the register level, inaccurate data cannot be uncovered. Some countries employ accountants, law firms or notary services to verify the information, but validation still has many flaws. That is especially true when it pertains to foreign owners, and/or the use of a front person to mask the ultimate beneficial owner. For example, in Italy, notaries play a key role throughout the lifecycle of most companies. The involvement of a notary or – in some instances – a chartered accountant or an accountant with other financial intermediaries, is necessary to establish the legal person and validate all changes to the basic information reflected in the register of legal persons. An important part of the notary's role is to ensure the accuracy of the information filed with the register. However, due to lack of the standard process or advanced tools in calculating or monitoring the beneficial ownership, there remain shortcomings in the verification process.

RECOMMENDATIONS

Although the verification on the accuracy of self-disclosed beneficial ownership is not always mandatory (e.g. CDD final rule), regulated firms should be aware of potential data quality issues. When facing high-risk customer onboarding or transactions, companies are advised to:

- Perform the appropriate level of beneficial ownership validation and investigation to mitigate risks.
- Consider working with an independent data provider that makes beneficial ownership data available. That can enable quick cross-checks. Alerts may also be generated if a discrepancy is detected.
- Consider creating a consortium. There may be benefits to gathering and cross-checking beneficial ownership data collected by other companies to uncover discrepancies. Currently there is no existing consortium that provides such a service, a jointly formed beneficial ownership consortium might be of value.

Access to the beneficial ownership data across jurisdictions remains challenging.

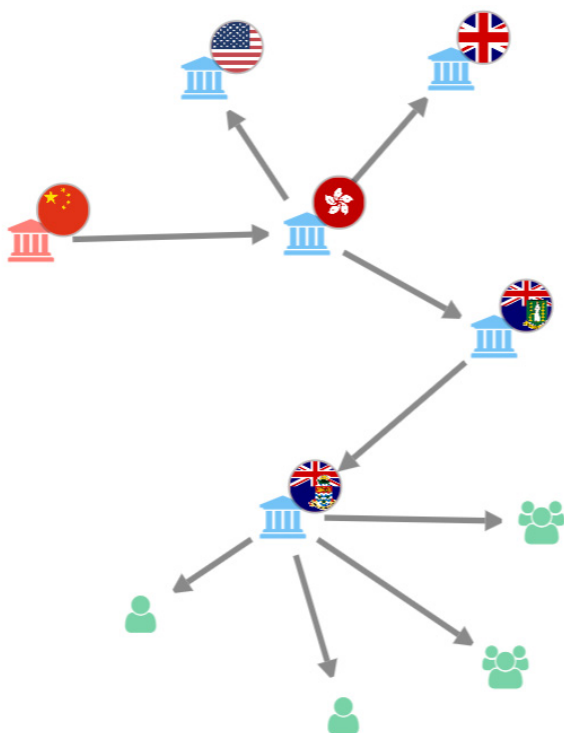
Accessibility of beneficial ownership data is another challenge, whether it is a domestic access limitation or a cross-jurisdictions limitation.

We often see US beneficial ownership data exclusively made available to authorized parties, but not to the public. In some countries, legal person formation and ownership data maintenance are managed within different sectors by law, such as the state registry office, the tax administration, central banks or credit bureaus. Often, these agencies are not digitally connected and cannot easily share the data with one another. For example, in Armenia, all legal persons are required to be registered in the country's state register, and basic information is publicly available. However, beneficial ownership information of all legal persons is maintained

by banks. These problems are amplified in the context of international data sharing.

Internationally, information sharing is also often subject to data protection and privacy laws, so transparency across jurisdictions is difficult. Considering the globalization of businesses today, whenever a linked entity is registered outside the jurisdiction where the subject entity is registered, the entity family map becomes more opaque and the beneficial ownership investigation can hit a wall. For example, when the parent entity is registered in Cayman Islands, further ownership information is extremely limited, and there can be a whole chain of parent entities above the Cayman Island entity that are not readily apparent.

In the following chart, the China-based entity in red is fully owned by a Hong Kong entity, which is further owned by three entities located in the US(5%), the UK(5%) and the British Virgin Islands (90%). Generally, we would consider the BVI entity as an end point if no ownership data is publicly available. However, the map indicates that there is an Cayman Island entity that fully owns the BVI entity, and there are four further owners of the Cayman Island entity. It means the ultimate beneficial owners are the owners of the Cayman Island entity.



RECOMMENDATIONS

It can be difficult for a regulated firm to gain access to beneficial ownership data in various jurisdictions, especially those with limited data accessibility. The investigation can become very inefficient when potential further ownership layers can not be seen. Here are some things that may help:

- Consider partnering with data providers that are capable of aggregating and linking data internationally. They can also provide that leverage powered by technology.
- Beneficial ownership challenges can be a good opportunity to streamline firm-wide master data. The better your master data is cleaned and governed, the closer you know the real owner of your customers.
- Outsource certain beneficial ownership collection and investigation tasks to a trusted managed service partner to leverage shared skills and programs.

CONCLUSION

Doing business in a not-so-transparent world is challenging, but solely meeting the minimum regulatory requirements is not sufficient enough to protect businesses. Global firms need to use all reasonable measures, including the use of third-party beneficial ownership data solutions, to stay compliant and further mitigate significant risks.



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