



## FIGHTING MONEY LAUNDERING IN THE EU: FROM SECRET OWNERSHIP TO PUBLIC REGISTRIES

The current review of the EU's 3rd Anti-Money Laundering directive, presents the opportunity to tighten anti-money laundering frameworks and set a strong precedent to close the loopholes in the current regime and focus on greater transparency of ownership for corporate vehicles.

Corruption around the world is facilitated by people's ability to launder and hide the proceeds of corruption. Dirty money enters the financial system and is given the semblance of originating from a legitimate source often by using corporate vehicles offering disguise, concealment and anonymity. All too often dirty money finds its way into European Union (EU) financial centres, undermining the EU's role as a global governance setter. Despite the strengthening of global anti-money laundering standards, such as those set by the Financial Action Task Force (FATF) and the United Nations Convention against Corruption, significant loopholes continue to exist in the EU and globally. A key loophole for money launderers is the lack of information collected and published on those who ultimately own and control companies, trusts and other legal structures.

There are serious social and political costs from money laundering, not least the undermining of governance standards, fostering of corruption and crime, distorting of the economy and impeding of development. The scale of illicit financial flows – from corruption, tax evasion and crime - indicate a systemic money laundering problem with often the poorest paying the price. In 2011, the developing world lost over US \$946 billion to illicit outflows, representing an increase of nearly 14 per cent over 2010<sup>1</sup>. Global detection rates of illicit funds by law enforcement are estimated to be as low as 1 per cent for criminal proceeds and the seizure rate is thought to be even lower, at 0.2 per cent (2011)<sup>2</sup>. With the EU set to review its anti-money laundering directive, now is the time to close the loophole that has kept the ownership of corporate vehicles secret and ensure this information is in the public domain.

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## THE ISSUE

### CLOSING THE LOOPHOLES

Public information about who has ultimate control and ownership of a company (the beneficial owner) is vital to fight financial crime and corruption effectively (see side bar). Companies involved in money laundering typically rely on being able to deposit their assets with a bank.<sup>6</sup> Without knowing the beneficial owner it is impossible for a bank to conduct a risk-based assessment and determine the legitimacy of the assets. Many studies have shown how anonymous shell companies and other corporate vehicles (such as trusts and foundations) are used as the conduit for the proceeds of corruption, tax evasion and other crimes.

Despite an important need for beneficial ownership information, few EU jurisdictions require these structures to share this information with their national authorities and currently no country makes this information freely available to the public<sup>7</sup>. According to the Organisation for Economic Co-operation and Development (OECD),<sup>8</sup> 16 of the 21 EU countries that are a member of FATF are either non-compliant or partially compliant with its recommendation<sup>9</sup> on corporate beneficial ownership, and none are fully compliant regarding beneficial ownership of other legal arrangements (such as trusts). On a more positive note, following the Group of 8 (G8) summit in 2013, a number of countries have promised to create a central registry of companies' beneficial ownership and many of the UK's overseas territories may follow suit.

After companies, trusts are the second most important vehicle used for corruption purposes, as identified by the World Bank and UN Office on Drugs and Crime.<sup>10</sup> This number is likely to be even higher as the misuse of trusts may be underreported. Any initiatives which would seek to shed light on beneficial ownership but fail to include trusts, foundations and other legal structures would leave open a significant money laundering loophole. As companies become more transparent, money launderers could exploit other corporate vehicles and simply reallocate their cash. So far few anti-money laundering measures have taken trusts, foundations and other structures into account. A positive example is France which adopted a law establishing a public register for trusts in 2013.<sup>11</sup>

## FINDING OUT WHO IS IN CONTROL

Control of a company, trust or alternative legal structures depends on the type of legal arrangement and can be exercised through legal ownership, contractually or informally. For companies, ultimate control is most often held by shareholders. Understanding who is in control of a corporate vehicle is essential for anti-money laundering purposes in order to identify the true person(s) behind it. However, special purpose companies may be structured in such a way that shareholders are meaningless and control is exercised through nominee managers and trust arrangements. Such situations complicate efforts by financial institutions and other service providers to ascertain the beneficial owner(s) and due diligence procedures should therefore go beyond basic checks to determine the person ultimately in control.

By their very nature, "ownership" is not a concept easily applied to trusts. Trusts lend themselves ideally to money laundering as they explicitly separate ownership from control. Given the myriad of forms that trusts can take, several different people could qualify as the beneficial owner depending on the case. This makes it essential that for purposes of anti-money laundering compliance, beneficial ownership information for trusts is understood to embrace the widest possible scope and include all those persons relevant to the trust.

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## WHO IS THE REAL OWNER?

A beneficial owner is the real person who ultimately owns, controls or benefits from a company or trust fund and the income it generates.

According to Transparency International, the term *beneficial owner* is used to contrast with the legal or nominee company owners and with trustees, all of whom might be registered as the legal owners of an asset without actually possessing the right to enjoy its benefits. Complex and opaque corporate structures set up across different jurisdictions, make it easy to hide the beneficial owners, especially when nominees are used in their place and when part of the structure is incorporated in a secrecy jurisdiction.<sup>3</sup>

## PURSUIING HIDDEN OWNERS: THE MAGNITSKY SCANDAL

Sergei Magnitsky was a Russian lawyer who died in prison in 2009 after exposing and testifying against senior Russian officials who were allegedly involved in a major corruption scandal.

As a lawyer for the US investment firm Hermitage, Magnitsky revealed that senior Russian officials were allegedly using Hermitage-owned assets to fraudulently reclaim US \$230 million in taxes. The funds stolen from his client reportedly disappeared into a maze of anonymous companies, crooked banks and offshore accounts<sup>4</sup>. Law enforcement and investigative journalists following the money trail have reported on links to anonymous companies in Moldova, the United Kingdom, British Virgin Islands and Cyprus, as well as banks in Austria, Cyprus, Estonia, Finland and Lithuania.<sup>5</sup>

To this day the whereabouts of hundreds of millions of dollars are still unknown, reportedly locked beyond opaque anonymous structures.

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## REAPING THE BENEFITS OF GOING PUBLIC

Making ownership information freely available in the EU is in the public interest (see side bar). Public registers would allow civil society, academics, journalists and ordinary citizens to scrutinise who owns companies and other legal structures, as well as to identify false or incomplete information and detect crime and corruption. Making beneficial ownership information available to the public is also likely to be cost-effective. Two cost-benefit analyses carried out by the European Commission in 2007 and by the UK Companies House in 2002 found that it would be more cost effective than keeping the registers closed.

Public registers can also enable government institutions to do their work better. For law enforcement, having critical information on beneficial ownership accessible, discreetly and at short notice, would greatly aid cross-border investigations. If ownership information is available only on demand, there is a real risk that money launderers will receive advance warning of an investigation and shift their assets to a different jurisdiction where they can be hidden again. Ultimately, the inability of law enforcement to obtain immediate information on beneficial ownership undermines its ability to combat corruption and financial crime. Public registers will also allow for greater information sharing and assistance in investigations between countries outside the EU.

There is also a business case for public information on ownership. While financial institutions are obliged to verify the identity of their clients through due diligence procedures, they often fail to do so. Recent consultations by FATF in 2011<sup>13</sup> and the European Commission in 2012<sup>14</sup> have found leading banking associations broadly in favour of increased transparency around beneficial ownership as a way to facilitate their due diligence obligations. The European Banking Federation has stated in its contribution for the review of the EU Anti-Money Laundering Directive that public registries are “imperative if credit and financial institutions are expected to discharge their obligations concerning Beneficial Ownership identification”. In addition, public registers are also likely to free up additional resources and result in lower legal and reputational risks for banks. Still, banks have a responsibility to conduct further due diligence and not rely solely on information from public registers (see side bar).

Public registers will also enable the business community to identify who owns the companies they are trading with, and thus better inform investment decisions within a healthy, functioning market economy. This point has also been made by the major business groups in the UK such as the Institute of Directors.<sup>15</sup> While businesses would have to provide information on their beneficial ownership to the public, this would not be a complicated exercise for most companies as their ownership structures are relatively simple. Companies that use multi-jurisdictional structures and that separate beneficial ownership from legal shareholding could face an additional reporting burden. However, given that these types of structures are often abused for money laundering or tax avoidance purposes, the additional requirements are warranted. To keep a level playing field and maximise their benefit, public registries must be made public in all EU member states as well as internationally.

## RECOMMENDATIONS

*For the 4<sup>th</sup> EU Anti-Money Laundering Directive:*

- Each EU Member State must collect beneficial ownership information in **public registers** that are freely available and in machine-readable formats.
- Publicly available information for each beneficial owner of a **company, trust or other legal arrangements** should include: full name, birth date, nationality, address of the registered office and the principle place of business (if different), as well as a description of how the ownership or control is exercised (such as the per cent of shares held).

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## PUBLIC VS. PRIVATE?

Privacy has been raised as a legitimate concern for the creation of public registries of beneficial ownership. This is particularly the case for trusts which are often used to hold money in trust for family members and for estate planning purposes. However, given the scale of financial crime made possible through corporate vehicles in the EU, privacy concerns need to be balanced against the need to prevent crime.

The European Court of Justice has supported this view, stating that limitations to data protection can be made when “necessary and genuinely meet objectives of general interest recognised by the European Union or the need to protect the rights and freedoms of others.”<sup>12</sup>

Further, the information collected for each beneficial owner would be limited to what is strictly necessary: full name, birth date, business address, nationality, and a description of how the ownership or control is exercised. Important precedents already exist in many countries where information is publicly reported for the general interest, including political donations, lobbying activities and salaries of public officials.

## CLOSING THE CIRCLE ON DUE DILIGENCE

Creating public registers of beneficial ownership (for companies, trusts and other legal structures) is not a “silver bullet” for tackling money laundering, and should not serve as an excuse for ineffective enforcement of Know Your Customer (KYC) policies by EU banks and other related due diligence measures.

Although more reliable and updated beneficial ownership information should make it easier for the financial sector to comply with anti-money laundering regulations, this alone is not enough.

As a result of greater transparency of beneficial ownership, governments and banking supervisory authorities should require banks to go further and improve their KYC procedures. In particular, efforts are needed at the EU level to improve information sharing between EU Member States regarding politically exposed persons (PEPs), which are at high risk for money laundering and other illicit activities.



- Publicly available information for each beneficial owner of a **trust** should include the identity of: the settlor (who donates the assets), the trustee (who manages the arrangement and is the legal owner), the protector (who may act as an intermediary between the settlor and the trustee), and the beneficiaries (who are to receive the funds).
- Willfully **misrepresenting beneficial ownership information** should be grounds for criminal and civil penalties including the possibility of imprisonment.
- Where directors or shareholders are fronted by **nominees**, this must be disclosed on record, including the name of the beneficial owner behind the nominee. Failure to do so should be grounds for criminal and civil penalties, including the possibility of imprisonment.
- Information sharing of lists of **politically exposed persons** should be enhanced between EU Member States.

#### **For EU Member States:**

- Put pressure on **secrecy jurisdictions** to establish public registers of beneficial ownership.
- Promote public registers of beneficial ownership in international fora such as the **G8 and G20**.
- Support the extension of the G20 Anti-Corruption Working Group mandate beyond 2014 and push for public registers of beneficial ownership in future action plans.

#### **For Financial Institutions and other service providers:**

- Obtain accurate, up-to-date **information on the beneficial owner** whatever structure (companies, trusts, foundations, etc.) is used.
- Ensure effective enforcement of **Know Your Customer policies**, and use public registers to improve their performance.

#### **NOTES**

- <sup>1</sup> Global Financial Integrity, "Illicit financial flows from Developing Countries: 2002-2011" 2013.  
<sup>2</sup> UNODC, "Illicit Financial Flows" 2011.  
<sup>3</sup> Transparency International, 'Financial Transparency Glossary' January 2014.  
<http://www.transparency.org/glossary/#/>  
<sup>4</sup> Mihai Munteanu (OCCRP), Roman Anin (OCCRP/Novaya Gazeta) and Bill Alpert (Barron's), 'Following the Magnitsky Money Trail.' 12 August 2012.  
<sup>5</sup> EU Observer, 'Latvia fines bank over Magnitsky Money Laundering' 20 June 2013.  
<http://euobserver.com/economic/120568>  
<sup>6</sup> See also: Global Witness, 'An Idiots Guide to Money Laundering' June 2012.  
<sup>7</sup> Christian Aid and Global Witness, 'Company ownership: which places are the most and least transparent?' November 2013.  
<sup>8</sup> OECD, 'Measuring OECD responses to illicit financial flows from developing countries' 2013.  
<http://www.oecd.org/dac/governance-development/IFFweb.pdf>  
<sup>9</sup> FATF, 'International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation - the FATF Recommendations' 2012.  
<sup>10</sup> Stolen Asset Recovery Initiative, 'Puppet Masters: how the corrupt use legal structures to hide stolen assets and what to do about it.' 2011.  
<sup>11</sup> Assemblée Nationale, 'Projet de loi relatif à la lutte contre la fraude fiscale et la grande délinquance économique et financière.' 5/11/2013. <http://www.assemblee-nationale.fr/14/pdf/ta/ta0237.pdf>  
<sup>12</sup> European Commission, 'Communication from the Commission on Safeguarding Privacy in a Connected World A European Data Protection Framework for the 21st Century.' 2012.  
<sup>13</sup> Financial sector responses to the FATF consultation on proposed changes to the FATF standards (7/01/2011): <http://www.fatfgafi.org/media/fatf/documents/publicconsultation/First%20public%20consultation%20document%20responses%20financial%20sector%20part%201.pdf>  
<sup>14</sup> Responses received by DG Internal Market, European Commission, on the application report for the review of the 3rd EU Anti-Money Laundering Directive (31/07/2012): [http://ec.europa.eu/internal\\_market/company/financial-crime/received\\_responses/index\\_en.htm](http://ec.europa.eu/internal_market/company/financial-crime/received_responses/index_en.htm)  
<sup>15</sup> Institute of Directors (IOD) 'Enhancing the transparency of UK company ownership and increasing trust in UK business' 16/09/2013.

Transparency International  
Liaison office to the EU  
Rue Breydel 40  
1040 Brussels  
Belgium

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

brussels@transparency.org  
www.transparencyinternational.eu

twitter.com/ti\_eu