UNDERSTANDING

BENEFICIAL OWNERSHIP STRUCTURES

The Intricacies of Ownership and Control

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Beneficial ownership identification and verification is now an essential component of client KYC onboarding and remediation processes. It is at the heart of the latest raft of international AML/CTF and sanctions regulations, as well as tax compliance laws and standards, such as FATCA and CRS. Although the impact on the financial services industry is widely acknowledged, other organizations with know your vendor (KYV) and know your third party (KYTP) disclosure obligations are also directly affected.

Scandals such as the Paradise Papers, the Panama Papers, Unaoil, and VimpelCom not only highlight the absolute need for robust customer due diligence (CDD), but have spurred the regulatory momentum for enhanced ownership disclosure and transparency. Failure to comply with the new, stricter regime carries significant reputational and financial risk for both corporations and individuals.

But while the penalties are clearly identifiable, peeling back the complex legal structures designed to conceal Ultimate Beneficial Ownership (UBO) represents a significant challenge. Confusion over multiple beneficial ownership definitions, a lack of accurate ownership registries, disclosure fatigue, and deliberate non-cooperation are additional hurdles.

This guide will help you better understand beneficial ownership legal structures and their complexities. It will also demonstrate how data and analytics can help improve the speed and accuracy of UBO identification, in addition to offering wider organizational benefits from enhanced knowledge management to resource redeployment.

Smoke and Mirrors

With millions of new companies being registered annually around the world, often with little information required, the sheer scale of identifying an organization's true owner cannot be underestimated. Complex ownership structures, such as nominee shareholders, and the existence of high-secrecy jurisdictions, such as the Cayman Islands, only further complicate beneficial ownership identification and verification. Although the role of offshore tax centers was already the subject of public outrage following more than a decade of corporate and public official scandals, it took the publication of the now notorious Panama Papers to demonstrate how flexible offshore legal structures, and the protection offered by offshore jurisdictions, significantly complicate beneficial ownership and UBO identification.

To date, few jurisdictions have defined beneficial ownership, its scope, or threshold. Further, while the numerous AML/CTF regulations and standards largely agree on a definition based on the G20/OECD/FATF principles, each has their own distinct thresholds – meaning that organizations have multiple beneficial ownership compliance initiatives to manage.

But beneficial ownership disclosure is nothing new. Legal frameworks governing the disclosure of ownership and control structures have long existed to ensure the prevention and detection of fraud, corruption, tax evasion, and criminal activity. Although most customers and third parties are legitimate well-run businesses, global terrorist events and geopolitical instability have exposed how terrorists, traffickers, and corrupt officials are funding themselves through financial networks. In response, governments and regulators have recently intensified their efforts to root out financial support to these criminals by requiring organizations to find out who really owns the businesses they deal with and ensure they are trustworthy.

*Source: 'Guidance on Transparency and Beneficial Ownership.' Financial Action Task Force/OECD 2014

Regulatory "Catch-22"

The new regulations have created a problematic paradox. The requirement for granular identification and verification has intensified, but access to information is limited, and legal concealment strategies are complex. Beneficial ownership and UBO rely heavily on customer self-certification, as well as information held in company registries and financial institutions, Trust and Company Service Providers (TCSP), regulatory bodies, or authorities.

However, most of these sources have limited or no access to offshore entities or contain unreliable, incomplete data.

According to the World Bank, even when public registries do exist, such as the UK's "Persons of Significant Control" (PSC) register, detailed information on UBO is rarely included because it is not mandatory. The trend globally is for governments and regulators to require more transparency, especially in offshore jurisdictions. Despite these efforts, uncovering information on the ultimate beneficial owners remains challenging. For example, UK legislation, including the Criminal Finances Act of 2017, introduced strict transparency standards for Crown Dependencies and Overseas Territories; however, the regions negotiated and made wide exemptions to retain certain levels of secrecy for registered entities.

While there are a raft of regulations, relying on one BO definition is not viable. For example, the FinCEN Final Rule doesn't require financial institutions to verify that the individuals listed as beneficial owners on self-certification were actually owners of the legal entity.

Without taking further steps to verify beneficial ownership, financial institutions may not be fully compliant with laws implemented in other jurisdictions, such as the 4th EU AML Directive.

KEY BENEFICIAL OWNERSHIP CHALLENGES

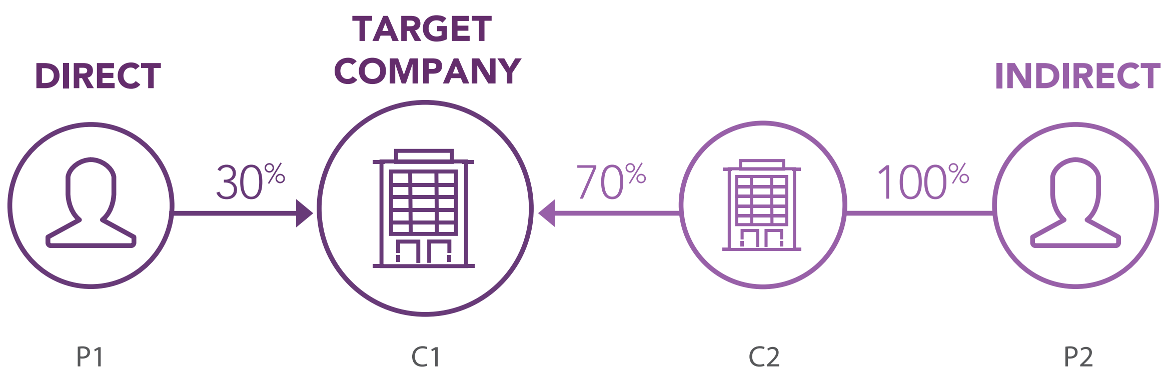
- The BO collection process adds a huge burden on the business's operations
- The lack of publicly available UBO registry data remains an obstacle in the entire AML effort
- Complexity and broadness of BO data is one of the biggest challenges for global companies.
- Non-standard documentation in offshore financial centers (OFCs)
- Flexible change of ownership in OFCs
- Navigating multiple layers of ownership
- Non-cooperation, grudging, or boilerplate disclosure

Adopting a Risk-based Approach

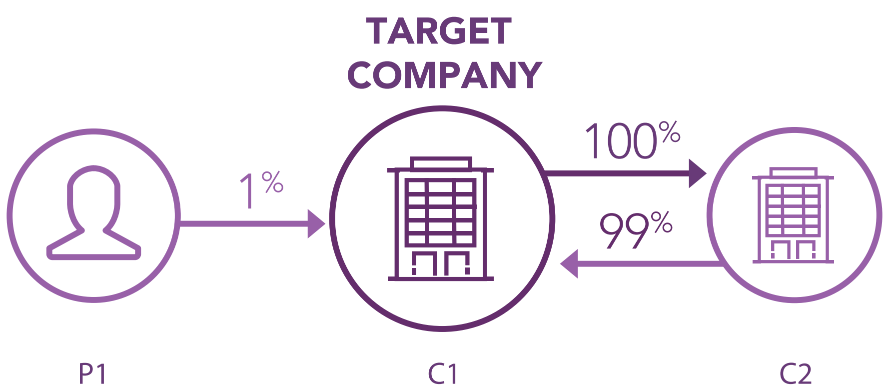
As a consequence of the changing regulatory landscape, coupled with the challenging nature of available information, UBO identification may seem an insurmountable task. It is usual practice for compliance teams to adopt a risk-based approach with standard thresholds for UBO identification and three lines of defense strategies so as to support straight through processing of business entities with limited risk. As a rule, beneficial ownership falls into three categories: executive directors (and/or senior officers), substantial shareholders (min 3% of an organization's securities) and de facto third-party shareholders. Calculating UBO is relatively straightforward for a publicly listed company with direct shareholders; it becomes more complex when ownership is obscured by layers of indirect ownership. These ownership structures present high levels of risk and, therefore, require greater scrutiny by compliance teams to demonstrate all reasonable measures have been taken to identify UBO.

Direct/Indirect and Looping Ownership

Beneficial Ownership is best visualized as a series of direct or indirect relationships. In the following diagrams, we have indicated levels of ownership between shareholders and the entities. While direct relationships are straightforward, the indirect relationship can equally be simplistic in its linkage. But in reality, complex structures are more common and granular in detail. In this example, Person P1 is a direct owner of Company C1 and owns 30% shareholding. Person P2 is an **indirect** owner of Company C1 and owns 70% shareholding.



In this scenario, we have a seemingly unimportant 1% owner. In reality, this individual is the only UBO, with all the profits being delivered to the UBO in 1% shares. For example, if the company makes a $10 profit, the UBO will receive full profit, but in 1% increments.



A Data-Inspired Approach

For many organizations, getting to the detail is not straightforward. Typically, it can take days to manually identify attributes (confirming self-certified information such as company name, address, registration details), verify those attributes (such as ownership levels and financial reports), and, if deemed necessary, conduct EDD. To calculate ultimate beneficial ownership, compliance teams often working in silos and — in different jurisdictions — have to rely on multiple reports and spreadsheets, as well as a range of online business information reports. These reports are inflexible, potentially inaccurate, and do not necessarily integrate with other systems and data sources. And of course, the structure can shift quickly, with small changes in one part affecting the whole.

For example, applying a traditional approach to corporate linkage to the multiple-level indirect shareholding scenario would fail, since there are two entities that have an equal 50% share rather than a single global parent. To be able to accurately verify and calculate the actual ownership, it is essential that accessible data *pulls together global corporate linkage and personal share ownership.* This can be achieved by harnessing data and analytics to automate the identification and verification of beneficial ownership.

By far the most common approach is to bring workflow and content together through Application Programming Interface (API) technology. API technology and data analytics pull together global corporate linkage in businesses and parental share ownership on demand. This dramatically accelerates the data capture process and ensures workflows can be built as needed, enabling straight through-processing where possible and directing complex remediation to the right teams quickly. Instead of using online business information reports and spreadsheets to calculate ultimate beneficial ownership, the analyst makes a query on the business entity in question via the API. This triggers analysis of the direct, indirect, and circular ownership structures of the business entity, and delivers back within seconds the relevant shareholders and their percentage ownership stakes. It also supports the building of an alerts methodology for changes to ownership. By breaking the remediation cycle and reacting to changes immediately, valuable resources can focus on the right customers and business partners, assessing changes that matter and acknowledging those that are not of material concern.

The ability to identify beneficial owners in a few clicks not only helps fast-track the standard on-boarding process, but frees up internal resources to focus on more complex investigations. Furthermore, by delivering this data into a central data repository and utilizing visualization software, other business units are able to access the same information, creating a relationship data supply chain that can expedite decision-making and organizational efficiency. Migrating to a data-inspired approach offers other value-added benefits too. In addition to reducing exposure to reputational risk (such as screening for potentially damaging PEPs), businesses can eliminate manual entry errors, enhance enterprise-wide knowledge management, and increase sector competitiveness and business agility while reducing operational costs.

KEY BENEFICIAL OWNERSHIP THRESHOLDS

FATCA - a 10% ownership threshold or below for Foreign Investment Vehicles

CRS - a 10% ownership threshold

OFAC - 50% rule

High risk or Politically Exposed Persons (PEP) - a threshold as low as 1% or 0.01% is required

FinCEN Final Rule - 25% ownership threshold

4th EU AML Directive - 25% shares or voting rights in a corporate entity. If, after having exhausted all possible means and provided no UBO is identified, the natural person(s) holding the position of senior managing officials are, in principle, considered to be the UBO

Dodd-Frank [sections 13(d) and 13(g)] - beneficial owner of more than 5% of certain equity securities are to disclose information relating to such beneficial ownership

SEC - 506(e) disclosure requires issuers to perform due diligence on any person that is going to become a 20% beneficial owner upon completion of a sale of securities

Beneficial Ownership Takeaways

Start small – Look at entities that have been sold higher-risk products and remediate them with data that can be consumed in bulk and stored locally, solving any immediate challenges.

Use API technology to build straight-through processes for new onboarding or KYC.

Embrace the power-of-change detection within a target entity or in entities associated in a beneficial ownership structure. Alerts recommending a re-run on a customer can minimize the effort of full reviews. Reacting to change immediately means far less effort down the line.

Conclusion

There is little doubt that confusion over multiple beneficial ownership definitions, a lack of public ownership registries, disclosure fatigue, and deliberate non-cooperation represent significant challenges to organizations affected by AML/CTF regulations. The globalization of beneficial ownership aided by the complexity of legal corporate vehicles and the use of offshore financial centers requires a forensic examination of data collected from multiple jurisdictions. For now, transparency over ultimate beneficial ownership is still the exception, not the rule, in many jurisdictions.

But even though the challenges are significant, data analytics is significantly easing the pain of beneficial ownership identification. By harnessing technology and exploiting on-demand, timely, accurate, and reliable data sources that pull together global corporate linkage on business entities and personal share ownership, organizations can be confident that they have achieved the single customer view they need to meet compliance challenges and mitigate reputational risk.

The advantages of a data-inspired approach can be enhanced by partnering with a trusted third-party data provider that is capable of verifying vast quantities of information acquired through a reliable, transparent data supply chain. While the "all reasonable measures" test is a regulatory minimum standard, relevant and high-quality data that is shared across the enterprise can help organizations move beyond compliance as a box-ticking obligation to become more agile and competitive.

To find out more about how to inject clarity, speed, efficiency, and protection into your Beneficial Ownership Compliance strategies, please visit **dnb.com/beneficialownership**