KEY POINTS

- Although the 4th Directive has brought some clarity to the obligations first introduced in the 3rd Directive, a new regulatory burden has been introduced in the form of the holding of information on beneficial ownership on a central register.
- What is still not answered is whether a top-down or bottom-up approach should be adopted.
- As with the 3rd Directive, there is no definition of what amounts to "control".

Feature

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The importance of beneficial ownership

Anti-money laundering legislation was first introduced in the early 1990s to combat the laundering of drugs money. It was limited initially to customer due diligence. In recent years it has been significantly extended to now include the owners of customers and it has introduced risk assessment. With complexity, uncertainty and ambiguity has been brought into this legislation. This has been recognised by the European Commission in the drafting of the 4th Directive.[1]

BACKGROUND

The first anti-money laundering directive was adopted by the then EEC in 1991[2] (1st Directive). This followed, but did not adopt, all the recommendations made by the Financial Action Task Force (FATF). The FATF is an inter-governmental body established in 1989 to set standards and to promote measures to combat money laundering and, more recently, terrorist financing. It describes itself as a "policy-making body"[3] and the policies that FATF has developed are to be found in their Recommendations (Recommendations).

The 1st Directive was limited in scope, it applied to credit and financial institutions and required identification of their customers. This directive was a minimum standards harmonising directive, a feature of all of the family of anti-money laundering directives. The regime under this directive was changed by the 3rd Directive[4] which introduced a qualitative test for customer due diligence and the requirement to look through the customer to their beneficial owners. Possibly a more logical approach would have been to have applied a risk methodology as to whether or not the institution required information about owners and beneficial owners.

BENEFICIAL OWNER

The 3rd Directive defined a "beneficial owner" as being a natural person who ultimately owns or controls the customer and the natural person on whose behalf a transaction or activity is being conducted.[5] The definition deemed that an owner or controller of 25% plus one share was a beneficial owner. There is an exemption from this requirement in the case of a company listed on a regulated market. It is not clear if the exemption applied where the listed company was the customer or in a corporate structure, if there was a listed company. It is far from clear how the 25% plus one share was to be determined. How this was to be applied to modern corporate structures was left to member states to make sense of in implementing the directive.

RISK-BASED MEASURES

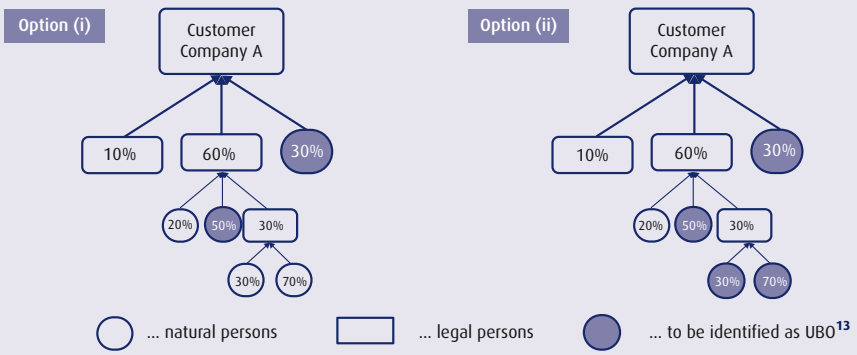
The 3rd Directive required that customer due diligence shall comprise of identifying the customer and the beneficial owner by 'taking risk-based and adequate measures to verify his identify'.[6] What are these "risk-based … measures"? The directive provides little help other than it will depend upon the obvious 'type of customer, business relationship, product or transaction'.[7]

IMPLEMENTATION OF THE 3RD DIRECTIVE

When it came to the UK government implementing the 3rd Directive (Regulation)[8] other than imposing upon the institution an obligation to take adequate measures on a risk-sensitive basis to verify the beneficial owners'[9] identity, there was no help in the Regulation as to what was a "risk-sensitive basis". The Regulation also does not help when it comes to working out how the 25% shares ownership is to be determined other than it being either direct or indirect.[10]

The calculation of the 25% plus one share threshold has led to differences in implementation by member states. In a report published in 2012 (Report) jointly by the European Securities and Markets Authority (ESMA), the European Banking[11] Authority (EBA) and European Insurance and Occupational Pensions Authority (EIOPA), it was reported that there were significant differences in the way that member states had implemented the beneficial ownership requirements and the interpretation of the risk-based approach 'which ranged from a high-level, principles-based legal and regulatory Anti Money Laundering/Counter Terrorist Finance (AML/CTF) framework to a predominantly rule-based approach where specific AML/CTF risks…are prescribed by public authorities'.[12] There was significant differences in the way customer's beneficial owners were identified with different ultimate beneficial owners of the same customer. This was a result of the different approaches to the application of the 25% plus one share threshold:

DIAGRAM 1:



Option (i) followed from a "top down" approach which 13 member states broadly followed and Option (ii) a "bottom up" approach which 11 member states followed.

There were also significant differences in the relation to the verification of the beneficial owner's identity. This ranged from verbal confirmation of the beneficial owner's identity to obligatory references to reliable and independent sources in all cases. There were also differences in the extent that member states required institutions to verify the customer's ownership structure.

UK GUIDANCE

The Joint Money Laundering Steering Group (JMLSG) is a private body representing UK trade bodies from the financial sector which publishes detailed guidance which seeks to interpret the law and regulations and to set good industry practice in AML/CTF (Guidance).[14] There are good and pragmatic reasons to follow the Guidance, as account must be taken by a court in deciding whether a person has committed a money laundering offence as to whether that person followed industry guidance.[15] However it is not a complete defence to show that the Guidance was followed, the defence (as provided for in the 3rd Directive) is to prove that all reasonable steps were taken and due diligence exercised to avoid the offence.[16]

The Guidance, so far as identifying the beneficial owner, does not gloss over the provision in the Regulation. The Guidance does go into some detail as to the assessment of risk which is to be welcomed but still leaves the assessment to be made by the institution. It is easy to describe the obvious risky persons but to take account of a complex business ownership structure for which there is no legitimate commercial rationale, this is a difficult assessment for a financial institution to make. One of the criticisms that can be made of the whole approach to money laundering is that the policing has been outsourced.

4TH DIRECTIVE

The 4th Directive had been proposed by the European Commission at the beginning of 2013 and it reflected in its drafting, the Recommendations. The European Commission sought to ensure consistency in implementation and to clarify the 25% ownership threshold and introduced the availability of beneficial ownership information.

The 4th Directive repeals the 3rd Directive[17] and we have now a new definition of beneficial owner,[18] a definition which is certainly going to be a challenge to implement in such a way that is certain and unambiguous. This is of importance not only for institutions and the JMLSG (as there is no doubt that the government will seek to outsource guidance to them) but also companies because of the imposition of a general disclosure obligation upon them. In the case of corporates the beneficial owner is the person who ultimately owns or controls a legal entity through ownership of a sufficient percentage of shares. Listed companies are excluded where the listing requires disclosure consistent with EU law or equivalent standards. But what is still not answered is how this is to be applied: whether a top-down approach is adopted or a bottom-up approach? We still have the 25% plus one share but this is taken as an indication of direct ownership and where this is held by a corporate entity and where that entity is controlled by a natural person or by multiple corporate entities which are under the control of the same person then that is to indicate indirect ownership. As with the 3rd Directive there is no definition of what amounts to "control", this would appear to be a matter of fact. Unhelpfully there is a reference to control "through other means" with a reference to another directive,[19] as the term "control" has been used in the proceeding sentence. This is not exactly of assistance.

Member states are permitted to decide on lower percentages to indicate ownership or control and if no natural person can be identified by the institution then senior management have to keep records of the actions taken to identify the beneficial owner.

As for risk assessment the European Commission is now charged with assessing risks and making the report available to member states and institutions in order to assist them "to identify, understand, manage and mitigate risk", an approach that has to be welcome.[20]

In the 4th Directive we now have some guidance as to risk factors but the guidance gives little assistance. There is reference to the purpose of the account; the level of assets; and duration of the business relationship.[21] The directive does set out a longer list of factors to be taken into account if the member states permit simplified due diligence.[22] This is a derogation that it is hoped that the UK government will take. There is, almost inevitably, another EU body involved in issuing guidance and that is the European Supervisory Authorities which guidance, on simplified customer due diligence, will be addressed to banks and financial institutions.[23]

Although the 4th Directive has brought some clarity to the obligations first introduced in the 3rd Directive and the UK government has the opportunity to improve upon the implementation of the 3rd Directive, a new regulatory burden has been introduced in the form of companies holding "accurate and current information on their beneficial ownership".[24] This information has to be held on a central register. It is imperative that there are clear and unambiguous rules for the determination of beneficial ownership for institutions, companies and their advisors. ■

1 Directive 2015/849/EC.
2 Directive 91/308/EEC.
3 www.fatf-gafi.org/about/whoweare/
4 Directive 2005/60/EC.
5 Article 3 (6) 3rd Directive; note the 3rd Directive repealed the 1st Directive as amended by the 2nd Directive.
6 Article 8 (1)(b) 3rd Directive.
7 Article 8 (2) 3rd Directive.
8 The Money Laundering Regulations 2007 (2007 No. 2157).
9 The Regulations refer to "his" in this context which under s 6(a) Interpretation Act 1978 is to be construed as importing the feminine gender.
10 Note 38 p 84 Recommendations 'any person owning more that a certain percentage of the company (eg 25%)'.
11 Report on the legal, regulatory and supervisory implementation across EU member states in relation to the Beneficial Owners Customer Due Diligence requirements under the Third Money

Biog box

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Laundering Directive [2005/60/EC].

12 Para 6 Report.

13 Para 27 Report.

14 The JMLSG Guidance published 21 November 2014 has still to be approved by the Treasury and therefore it is the previous approved guidance that would be relevant when being taken into account by the court.

15 Para (2) Regulation 45 The Money laundering Regulations 2007.

16 Para (4) Regulation 45 The Money Laundering Regulations 2007.

17 Article 66 4th Directive.

18 Article (3) (6) 4th Directive.

19 Directive 2013/34/EU Art 22(1) to (5); these are provisions setting out the circumstances where consolidated financial statements are to be drawn up.

20 Article 6 4th Directive.

21 Annex I 4th Directive.

22 Article 15 and 16 and Annex II 4th Directive.

23 Article 17 4th Directive.

24 Article 30 4th Directive.

Further Reading:

- The devil is in the detail: the Fourth Money Laundering Directive in practice [2014] 5 JIBFL 308.
- Proposed US rule requires banks to collect beneficial ownership information [2014] 10 JIBFL 651.
- LexisNexis Financial Services blog: Full speed ahead on the Fourth Anti-Money Laundering Directive.