Portfolio Media. Inc. | 111 West 19th Street, 5th Floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

UK Overseas Territories Disclosure Rule May Be Premature

By **Ian Hargreaves and Stephanie Sarzana** (July 11, 2018, 12:16 PM EDT)

Ian Hargreaves

Stephanie Sarzana

Following the recent spate of money-laundering scandals, from the Brazilian "Operation Car Wash" in 2014, to the Panama Papers in 2016, and the Paradise Papers in November 2017, the offshore financial industry is coming under increased scrutiny. It is therefore unsurprising that the United Kingdom would legislate to improve the financial reporting transparency of its overseas territories.

Section 51 of the Sanctions and Anti-Money Laundering Act 2018 (passed on May 1, 2018, and granted royal assent on May 23) imposes public beneficial company ownership registers — similar to the one currently in place in the U.K. — in the British overseas territories. More specifically, Section 51 instructs the secretary of state to "provide all reasonable assistance" to the overseas territories to "establish a publicly available register of the beneficial ownership of companies" registered in those jurisdictions.[1] If the territories have failed to do so by Dec. 31, 2020, the secretary of state must prepare an order in council requiring any noncompliant governments to establish these registers.[2]

A general push for enhanced disclosure can only be welcomed. The National Crime Agency recently claimed that previous assessments of 36 to 90 billion pounds in money-laundering losses impacting the U.K. "is a significant underestimate."[3] However, the question remains as to whether this last-minute cross-party amendment (tabled in the House of Commons in April 2018) is the correct means to reach a worthy goal. Two sets of issues must be considered in this regard: some legal, others practical.

Legal Implications of Section 51

First, from a legal perspective, it remains questionable whether the U.K. government can legislate for the overseas territories without their consent. Parliament has done so only twice in the past, in the human rights arena (to abolish the death penalty in 1991, and to decriminalize homosexuality in 2000).

There are no clear rules to determine when it is appropriate for the British government to legislate for the overseas territories. A 2012 government white paper describes the constitutional position of those jurisdictions: "[a]s a matter of constitutional law the UK Parliament has unlimited power to legislate for the Territories. […] [P]owers are devolved to the elected governments of the Territories to the maximum

extent possible consistent with the UK retaining those powers necessary to discharge its sovereign responsibilities."[4] The question then becomes whether regulating the financial industry is necessary for the U.K. to discharge its sovereign responsibility.

As can be expected, there is little parliamentary or governmental guidance on this topic. Some direction, however, can be found in the overseas territories' constitutions. These consistently contain a clause reserving to "Her Majesty full power to make laws for the peace, order and good government of the […] Islands"[5] or very similar language.[6] Therefore, Parliament can legislate directly for the territories to maintain "order and good government," which arguably could include financial reporting and transparency.

Generally, however, the U.K. government's freedom of action with regard to overseas jurisdictions lies in custom rather than in law. Accordingly, in this particular instance, the territories' constitutional autonomy may hinge on how vital Section 51 is to each member of Parliament. Baroness Vivien Stern argued during House of Lords debates that "the levels of fraud, tax evasion and corruption that are causing so much misery in the poorest parts of the world are an abuse of human rights and the rule of law," to justify the U.K.'s direct interference in the overseas territories' financial regulation.[7] By contrast, the minister of state argued that "Financial services are the domestic responsibility of territory Governments" to dissuade from direct involvement.[8] Thus, whether or not Section 51 is constitutional is very much a matter of opinion. None of this, of course, affects the validity of the provision. Section 51 is lawful, albeit perhaps unconstitutional in the eyes of some, and would likely stand up to judicial review.

In fact, whether the U.K. government can legislate directly for the overseas territories in matters of financial transparency is not as much a major constitutional or legal step, as it is a political (and thus more difficult) one. Indeed — and understandably — many of the overseas territories voiced their disappointment at the passing of the act (seen as encroaching on their right to self-government), claiming it "damag[ed] the historically strong relationship"[9] with the U.K. and amounted to "modern colonialism."[10]

Practical Implications of Section 51

Constitutional and political considerations aside, Section 51 also poses a number of practical questions.

First, Section 51 may not be as efficient a weapon against money-laundering as one hopes. In its Written Evidence to the House of Commons Public Bill Committee, the International Financial Centres Forum urged to forgo the idea of public registers in favor of maintaining the existing government-held registers. Public registers (such as the one set up in the U.K.) are based on self-reporting, without real means of verification or monitoring, and according to IFC, "tend to be inaccurate."[11]

Comparatively, the territories' central registers (for the major financial hubs of the Cayman Islands, British Virgin Islands, Bermuda and Gibraltar) are systematically verified by licensed and regulated corporate services providers.[12] Data reported by IFC suggested that the overseas territories display some of the highest verification ratings in the world, with a circumvention prevention rate of 100 percent in the Cayman Islands, 94 percent in the BVI, 88 percent in Gibraltar and 79 percent in Bermuda (compared to 51 percent in the U.K. and only 25 percent in the United States).[13] Moreover, the territories' registers are accessible to U.K. law enforcement or HMRC within 24 hours of a request (and one hour if urgent). In summary, the central registers are verified, potentially more accurate, and can be accessed quickly by the competent authority as and when needed.

Moreover, imposing open beneficial ownership may only result in dirty money fleeing to more opaque overseas localizations with no registers, making illicit transfers harder to trace.

Second, forcing public registers on the overseas territories at this stage may be premature. The Criminal Finances Act 2017 mandates the U.K. government to monitor the territories' current central registers, with progress reports due in July 2019.[14] By imposing new public registers before these reports are due, Section 51 effectively short-circuits the Criminal Finances Act 2017, negating years of work and incurring additional costs for the territories (already cash-constrained after Hurricane Irma).

Third, imposing open registers on the overseas territories may be moot, as these jurisdictions are already compliant with Organisation for Economic Co-operation and Development standards. In 2017, the territories committed to reaching the OECD's Standard for Automatic Exchange of Financial Account Information.[15] Currently, five of the main financial offshore centers (the BVI, Cayman Islands, Bermuda, Gibraltar, and Turks and Caicos), are rated "largely compliant" by the OECD Global Forum on Tax Transparency and Exchange of Information for Tax Purposes — the same rating as Switzerland, Luxembourg, the United States and the U.K.[16]

However, open registers retain certain advantages. First, they would allow any user, including journalists and transparency NGOs, to access certain information, enabling them to "connect the dots" without an official investigation underway. Second, they will push the overseas territories at the forefront of beneficial ownership reporting, given that public companies registers may become the global standard under a fifth EU Anti-Money Laundering Directive.

It is worth noting that Section 51 does not extend to the crown dependencies. Jersey, Guernsey and the Isle of Man were originally subject to a regime similar to that of the overseas territories to create a level playing field. This amendment, however, was defeated in the House of Commons by a majority of 301 to 180. The need for public registers in the crown dependencies might be less compelling, for two reasons.

First, forcing open registers on the crown dependencies risked sparking a constitutional crisis. According to the Ministry of Justice Fact Sheet on the U.K.'s relationship with the crown dependencies, "UK legislation rarely extends to the Crown Dependencies and should not be extended without first consulting the Islands' Authorities and obtaining their consent."[17] An act of Parliament may extend to the crown dependencies through an enabling provision for an order in council (a "permissive extent clause" or PEC).[18] As a general rule, "a PEC should not be included in a Bill without the prior agreement of the Islands."[19] For an act to extend other than by an order in council "is now very unusual."[20] Therefore, legislating for the crown dependencies through the Sanctions and Anti-Money Laundering Act without an order in council and without their prior agreement would have been highly problematic — more so than for the overseas territories.

Second, the crown dependencies (which currently have central beneficial ownership registers, albeit not public ones) are listed as "fully compliant" by the OECD Global Forum on Tax Transparency and Exchange of Information for Tax Purposes.[21] Accordingly, establishing public registers in the crown dependencies may not be essential to curb money-laundering risks.

Tory MP Andy Mitchell, one of Section 51's early defenders, explained that the crown dependencies' "slightly differing governance structure made it too complicated to put them in the same amendment [as the British Overseas Territories]. […] But we expect the Crown Dependencies to adopt the same open register as the Overseas Territories. Why? Because they share our Queen, trade under our flag, and accept our same values."[22]

Given that the EU has recently agreed a fifth Anti-Money Laundering Directive requiring public registers, it may be less a question of if, but rather of when, the crown dependencies will accept this reporting mechanism. In this context, it is not a bad outcome that the overseas territories must begin the process early.

Ian Hargreaves is a partner and Stephanie Sarzana is a special counsel at Covington & Burling LLP.

[1] Sanctions and Anti-Money Laundering Act 2018, s 51.

[2] ibid.

[3] National Crime Agency, 'National Strategic Assessment of Serious and Organised Crime' (2017) para 41 accessed 20 June 2018.

[4] Foreign and Commonwealth Office, 'The Overseas Territories: security, success and sustainability' (28 June 2012) 14 accessed 20 June 2018.

[5] The Virgin Islands Constitution Order 2007, SI 2007/1678 art 119 ('There is reserved to Her Majesty full power to make laws for the peace, order and good government of the Virgin Islands.'); The Cayman Islands Constitution Order 2009, SI 2009/1379 art 125 ('There is reserved to Her Majesty full power to make laws for the peace, order and good government of the Cayman Islands.').

[6] The Constitution of Anguilla contains a similar provision at Article 9: 'Her Majesty reserves to Herself power, with the advice of her Privy Council, to make laws for the peace, order, and good government of Anguilla.' (Anguilla Constitution Order 1982, SI 1982/334 art 9). The Constitution of the Falkland Islands states at Article 11: 'There is reserved to Her Majesty full power to make laws for the peace, order and good government of the Falkland Islands including […] laws amending this Order or the Schedule.' (Falkland Islands Constitution Order 2008, SI 2008/2846 art 11). The Constitution of the Turks and Caicos Islands provides similar language: 'Her Majesty reserves to Herself power, with the advice and consent of Her Privy Council, to make laws for the peace, order and good government of the Turks and Caicos Islands.' (Turks and Caicos Islands Constitution Order 2011, SI 2011/1681 art 14).

[7] HL Deb 17 January 2018, vol 788, col 688.

[8] ibid, col 687, citing Sanctions and Anti-Money Laundering Bill Deb 6 December 2017, col 1117.

[9] Government of the British Virgin Islands, Written Evidence submitted to the Public Bill Committee, Sanctions and Anti-Money Laundering Bill (5 March 2018) 1 accessed 20 June 2018.

[10] Henry Mance and Madison Marriage, 'Caymans, Bermuda and BVI Face New Corporate Transparency Laws' Financial Times (London, 1 May 2018).

[11] International Financial Centres Forum, 'Written Evidence submitted to the House of Commons

Public Bill Committee, Sanctions and Anti-Money Laundering Bill', 5 March 2018, para 1.3. accessed 20 June 2018.

[12] ibid, para 2.2.

[13] ibid, citing Michael Findley, Daniel Nielson, and Jason Sharman, Global Shell Games (Cambridge University Press, 2015).

[14] Criminal Finances Act 2017, s 9 (stating in relevant part: '(1) The relevant Minister must prepare a report about the arrangements in place between (a) the government of the United Kingdom, and (b) the government of each relevant territory, for the sharing of beneficial ownership information. (2) The report must include an assessment of the effectiveness of those arrangements, having regard to such international standards as appear to the relevant Minister to be relevant. (3) The report (a) must be prepared before 1 July 2019…').

[15] European Parliament Research Services, 'Tax evasion, money-laundering and tax transparency in the EU Overseas Countries and Territories, Ex-Post Impact Assessment, Study' (April 2017) pt 6.3.1. accessed 20 June 2018.

[16] OECD, OECD Global Forum on Tax Transparency and Exchange of Information for Tax Purposes, accessed 20 June 2018.

[17] Ministry of Justice, 'Fact Sheet on the UK's relationship with the Crown Dependencies' 1 accessed 20 June 2018.

[18] ibid, 2.

[19] ibid.

[20] ibid.

[21] OECD, OECD Global Forum on Tax Transparency and Exchange of Information for Tax Purposes accessed 20 June 2018.

[22] Adrian Darbyshire, 'Did Lobbying Really Stop UK Acting on Register?' Manx Independent (Isle of Man, 7 June 2018).