Chapter 8:

Beneficial ownership registers under the Fourth and Fifth Directives

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Anonymously-owned companies are a familiar mechanism, allowing tainted funds to move undetected. If the tide of money laundering channelled through corporate vehicles is to be prevented or at least made more difficult, public registers of every company's "ultimate beneficial owners" ("UBOs") are an important part of the solution. To effectively deter and detect corruption and money laundering, the ultimate goal has to be to have compatible public UBO data from different countries linked in a manner that is useful for law enforcement. This would make it far easier to "follow the money" in large corruption cases such as the Danske Bank case, in which tainted funds from Russia and other ex-Soviet states were funnelled through the bank's Estonian branch to the tune of €200 million.

Improved access to beneficial ownership registers is a key requirement under MLD4 and MLD5. MLD4 introduced a requirement for publicly accessible, interconnected UBO registers for companies and other legal entities which requires them to obtain and hold adequate, accurate and current information on their UBO, including details of the beneficial interests held.

This chapter outlines the requirements for transparency of UBO under MLD4 and MLD5, the areas of oversight, and the problems of implementation. Implementation is characterised by a push for easy register access, challenges in data reliability and verification, harmonisation hurdles, as well as the potentially discretionary nature in which directives are implemented, creating a leaky system.

Cross-EU implementation of UBO registers

Since 2015, laws requiring UBO registration have been approved (or are required to be approved by 2020) in a total of 45 jurisdictions around

the world. However, with EU directives only providing frameworks and mandated targets for implementation by member states, implementation is inconsistent. This creates compliance issues for multinationals with subsidiaries across the 28 member states. No country has achieved the ideal level of UBO registration for every type of legal vehicle.

The deadline for member states to adopt legislation to implement MLD4 was 26 June 2017, yet debates are still ongoing about how MLD4 should be implemented, who should have access to the registers, and how much the legislation will improve transparency in practice. Only a few countries met the deadline for integrating UBO registers into their laws by the end of June 2017, the deadline under MLD4. The table below provides an overview of how some member states are implementing the requirement to maintain UBO registers in their national law.

Country	MLD5 and the UBO register implementation status
Belgium	The Belgian UBO register was launched on 1 October 2018, although the deadline for Belgian companies to upload and complete information on the register is 31 March 2019. Members of the public have restricted access to the UBO register. Given that companies have until 2019 to update the Register, it seems likely that the Register will be lacking information until this deadline.
Czech Republic	The implementation of MLD5 is at an early stage in the Czech Republic but it has been flagged that significant changes to the Czech rules which govern UBOs are to be expected. The rules are likely to become more detailed as they seek to implement MLD5.
France	MLD5 is yet to be fully transposed into French law, although a draft bill is currently being considered by the French National Assembly in order to allow the government to transpose the directive through orders. In response to the implementation of MLD4, a new decree entered into force on 21 April 2018 which includes provisions on UBOs. This decree specifies what is meant by a "beneficial owner" – this includes whether the owner owns, directly or indirectly, more than 25 percent of the capital or votes, or if they have control over the company in a way that allows them to determine decisions in general assemblies of the company.
Germany	MLD5 is yet to be implemented in Germany. MLD4 has been effective since 26 June 2017 in Germany and this established the German UBO register. The requirement under MLD5 that UBO registers are to be public is still to be satisfied as the current register only grants immediate access to certain authorities and individuals who can show they have a "legitimate interest".

Hungary	The deadline for the database setup in relation to the implementation of the UBO register in Hungary is 1 January 2019. Currently, third persons may request data from the central register, but this is granted to those with a "legitimate interest" only.
Italy	The UBO register has not yet been implemented in Italy despite MLD4 having been implemented by Decree no. 90/2017. Second-level legislation is required to provide details on how companies' obligations to disclose their UBOs should be carried out in practice; however, the deadline for issuing second-level legislation expired in July 2018. The implementation of the UBO register could be postponed until after the implementation of MLD5.
Luxembourg	Two UBO registers are in the process of being created in Luxembourg by two different laws. On the one hand, there will be a register of UBOs of companies and similar entities registered with the Luxembourg trade and companies register. On the other hand, there will be a register of fiduciaries (corresponding to the register of trusts in MLD4). The transposition of MLD5 has not started yet.
The Netherlands	Implementation of MLD5 has been put on hold while a new draft bill (set to be published in early 2019) is prepared. The implementation deadline of the UBO register in the Netherlands has been extended to 18 months post-implementation of MLD5.
Poland	The Act that implemented MLD4 postponed the implementation of a UBO register until 13 October 2019 in Poland. The Polish government has not yet started working on the implementation of the additional requirements of MLD5.
Romania	MLD4 has not yet been adopted in Romania and the European Commission has begun infringement procedures in respect of this. The current draft law that would transpose MLD4 into Romanian law does not include provisions that would meet the MLD5 requirements on UBO registers.
Spain	MLD5 has not yet been implemented in Spain although the Spanish Council of Ministers approved Royal Decree 11/2018 in August 2018 on the transposition of a number of directives, which includes the prevention of money laundering. This entered into force on 4 September 2018 and incorporates MLD4 within Spanish law. It requires entities subject to MLD4 to indicate their real owners and to keep a record of this in a marginal note within the relevant Commercial Registry filing.
UK	Member states are required to transpose MLD5 by 10 January 2020. This will be after the UK has formally left the EU, but within the transitional period currently envisaged in the draft EU Withdrawal Agreement. It is therefore assumed that the UK will implement MLD5 in full.

Penalties

Failing to comply with the registration requirements may result in substantial fines in the various member states. Member states have introduced a wide range of penalties for non-compliance, from an administrative fine of around €1,300 (in proposed legislation in Italy and Lithuania) to 10 percent of annual turnover, with a minimum of €5 million (in the proposed Luxembourg legislation). The UK considers willful non-compliance a criminal offence (which may result in a two-year prison sentence).

Access to register

Under MLD4, UBO information must be held in a central register in each member state. Member states can make the register public, or at a minimum available to competent authorities (e.g. law enforcement), financial intelligence units (in the UK this is the National Crime Agency), without any restriction, and obliged entities (see examples below), for customer due diligence ("CDD") purposes (Article 31(4) of MLD4). Others with a "legitimate interest" have appropriate degrees of access to the information (Article 30(5)). Obliged entities include credit institutions, financial institutions, auditors, external accountants and tax advisers, independent legal professionals (when acting in their professional capacity), trust or company service providers and estate agents.

In MLD4, there was no clarification of what might constitute a "legitimate interest". The concept of legitimate interest has been clarified to some extent by MLD5. A "legitimate interest" (which may relate to the prevention of money laundering, terrorist financing and associated offences) must be "justified by readily available means, such as statutes or mission statements of non-governmental organisations, or on the basis of demonstrated previous activities" relating to the fight against these offences.

In addition, Article 1(15)(c) of MLD5 provides that members of the general public are to have access to at least the following information held in the central register: the name, the month and year of birth and the country of residence and nationality of the beneficial owner, and the nature and extent of the beneficial interest held.

Beneficial ownership registers – trusts

On 6 April 2014, the UK became the first EU and OECD country to enact legislation requiring every UK registered company, limited liability partnership and Societas Europaeae to create a register of "people with

significant control" ("PSC") ("PSC Register"), and to make that register available to the public. The only departure from an indiscriminate publication policy in the legislation is a concession to individuals who can show to the satisfaction of the registrar that to publish their personal particulars would put them or those that live with them at serious risk of violence or intimidation. To date, 98 percent of companies have provided information regarding their PSCs. This is a qualified success, as the accuracy of this information has been questioned. At present, trusts are not included in the PSC legislation but under Article 31(1) of MLD4, trustees of any express trust (i.e. an arrangement with a clear and deliberate intention to create a trust, as opposed to statutory, resulting or constructive trusts, whether the trust generates tax consequences or not) must obtain and hold adequate, accurate and up-to-date information on UBO of the trust. That information must include the identity of the settlor, the trustees, the protector (if any), the beneficiaries or class of beneficiaries and any other natural person controlling the trust (Article 31(1) of MLD4).

Under Regulation 44 of the UK Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017, SI 2017/692 ("2017 MLRs"), trustees must maintain accurate and up-to-date records in writing of all the UBOs of the trust and any potential beneficiaries. The information that must be provided is extensive. UK HMRC is required to maintain a register of beneficial owners and potential beneficiaries of "taxable" relevant trusts (see above). Accordingly, trustees must provide to HMRC the information it is required to record about beneficial owners and potential beneficiaries together with information about the trust itself. This information had to be provided on or before 31 January 2018, or if the trust is not yet taxable, on or before 31 January after the tax year in which the trustees are first liable to pay taxes. In addition, trustees will be required to advise the obliged entity that they are acting as trustee and provide information identifying all the UBOs of the trust which in the case of a class of beneficiaries, may be done by describing the class of persons (Regulation 45(2) of the 2017 MLRs).

This is not the end of the story, however, for trusts. The UK HMRC Trust Registration Service ("TRS") had been established to register all express trusts where the trusts had a tax consequence. However, in June 2017, MLD5 referred to the removal of the tax consequence requirement and provides that all express trusts must be registered from 10 March 2020. This means the majority of trusts in the UK may now have to be

registered. This may include "dormant trusts" or those that do not yet have active assets, such as life insurance policy trusts, discounted gift trusts (and perhaps even some assets owned jointly). Offshore trusts created by non-EU residents that relate to UK properties and business will also have to be registered. It is estimated that around two million trusts will be affected. Details of the trust's beneficial owners – including settlor(s), trustees and beneficiaries – and the value of the assets at the start of the trust must be disclosed on the trust register. Once registered, the trustees must ensure that the trust's details on the register are accurate and kept up-to-date.

In addition, under article 1(16)(a) of MLD5, legal arrangements having a structure or functions similar to trusts must also be registered. These changes therefore present a challenging and onerous task for businesses – to identify all such trusts and register their UBO by no later than January 2020, as well as to build the appropriate systems to comply with the registration obligation for all new trusts.

MLD5 also provides for member states to ensure that breaches of the requirement to register UBO information are subject to effective, proportionate and dissuasive measures or sanctions. Further, there is a requirement for beneficial owners to provide all the information necessary for corporates and other legal entities to comply with their registration obligations. It remains to be seen what form these measures will take.

Proposed UBO registers for other entities

In 2016, the UK's Department for Business, Energy and Industrial Strategy, proposed that various entities – e.g. Scottish partnerships and Scottish Limited partnerships ("SLPs"); building societies; unregistered companies – are brought into the scope of the PSC requirements. SLPs are a well-known vehicle of choice for moving ill-gotten gains around the world, owing their popularity in part to easy set-up requirements and minimal filing requirements with the UK's companies registrar, Companies House. Since this announcement, the number of new incorporations of SLPs has fallen dramatically. This is encouraging, as there has been growing concern in recent years that limited partnerships are being used for illicit purposes and they have featured prominently in several large corruption cases, including the Russian and "Laundromat" case, which saw at least US$20 billion of tainted money flushed out of Russia, made possible by alleged corruption in Moldova and the ease at which its organisers could create ghost companies to receive payments, especially in Scotland.

Nevertheless, due to the continued use of such vehicles for fraudulent purposes – such as in the Danske Bank case – in April 2018, the UK government published a consultation on UK limited partnership law. The proposed reforms set out in the UK government's response, which was published in December 2018, include – amongst other matters – tightening of registration requirements for limited partnerships, ensuring that those applying to register limited partnerships demonstrate that they are registered and supervised by an official anti-money laundering supervisor; requiring limited partnerships to demonstrate a firmer connection to the UK; and increasing transparency requirements. The proposed reforms require primary legislation, and the UK government is intending to legislate as soon as Parliamentary time allows.

Level playing field

Indeed, the EU should require that any country with a special treatment or agreement with the EU in terms of market access and other benefits (e.g. Andorra, Liechtenstein, Switzerland, as well as UK dependent territories) should be equally required to implement the UBO requirements for their legal vehicles. To date, British Overseas Territories ("BOTs") are required to create public UBO registers for companies registered in their jurisdiction by 31 December 2020 under the Sanctions and Anti-Money Laundering Act 2018 (Commencement No. 1) Regulations 2018. The British Virgin Islands' branch of the Panamanian law firm Mossack Fonseca is a case in point of the need for greater UBO oversight in these jurisdictions. The firm received worldwide media attention in April 2016 when the International Consortium of Investigative Journalists published confidential information in the Panama Papers about its clients' (mostly offshore entities) financial dealings. During this leak, it was found that no one at the firm really knew who owned almost 20,000 of their active clients – 70 percent of the companies they were working with.

A similar provision was proposed for the UK's Crown Dependencies – the Channel Islands (including Jersey, Guernsey, Alderney and Sark) and the Isle of Man – but was withdrawn because it was felt that agreement would be reached without the need for UK legislation (putting aside constitutional questions of whether the UK can legislate for the Crown Dependencies without their consent). This mismatch shows how difficult it is to achieve harmonisation.

For UBO registration to be considered effective, loopholes and exceptions need to be addressed. UBO registration should not be considered effective if, for example, the obligation to identify UBOs of an entity

is waived because the entities in the ownership chain are foreign (e.g. Germany) or if entities are given too much leeway or ambiguous conditions to determine that they are unable to identify their UBOs (e.g. Denmark).

Reliability of information

In the UK, companies must keep details of their UBOs current and update Companies House once a year when completing the Confirmation Statement, which replaced the annual return (Articles 30(2) and (5) of MLD4, section 81 Small Business, Enterprise and Employment Act 2015). Article 1(15)(b) of MLD5 adds a requirement for obliged entities to report any discrepancies they find between the UBO information available in the central registers and the UBO information available to them.

A challenging component of the legislation centres around the reliability of information entered on the registers. This information is often provided to registrars unmediated by regulated professionals and is unverified; the quality and usefulness of such information therefore may be compromised. Article 1(16)(f) of MLD5 adds a requirement for obliged entities to report any discrepancies they find between the UBO information available in the central registers and the UBO information available to them. Of interest is how member states are expected to track whether these discrepancies are reported often, or if at all. Information held on these registers is vital in building a picture of corporate transparency and their links with the wider law enforcement network help ensure that money laundering is tackled effectively.

Further, many international company registrars do not have the necessary resources in place for monitoring this information on their registers. It is matter of public record in the UK that many companies have misunderstood the requirements and have therefore provided incomplete or incorrect information, or have deliberately provided false information, or no information at all. This could be to cover fraud or money laundering activities. It is no small feat for the registrars to monitor information reliability: the UK's Companies House has 3.9 million companies on its register and is woefully understaffed, especially if it is also to be treated as responsible for verifying the reliability of information provided. This will be an ongoing challenge for international registrars who will need to work with others across the law enforcement network to ensure information is shared correctly and to support the tackling of economic crime. In the UK, Companies House

will be working with the UK's Insolvency Service criminal enforcement team to investigate non-compliance.

Ambiguities in the text – impact on the transposition?

Certain ambiguities in the texts of MLD4 and MLD5 will likely manifest in an application of these directives that is subject to great subjectivity. In the UK, "beneficial ownership" is defined as any natural person who ultimately owns or controls a corporate or legal entity and/or on whose behalf the entity is conducting its activity. In the case of corporate entities it relates in part to a natural person who ultimately holds a shareholding/controlling interest or ownership interest of 25 percent plus one share or ownership interest. In some cases, 25 percent plus one could also be applied to those with voting rights, not only to shareholdings. This "more than 25 percent threshold" means in practice that any company with at least four shareholders (e.g. two parents and two children or four friends) with equal shareholdings or voting rights will have no UBO at all because none of them would trigger registration requirements – each shareholder would "merely" have 25 percent. Criminals (the real target of these directives) may simply join forces with three others, and thus avoid being identified. Establishing "control" where someone owns 25 percent or less is more difficult especially where the body responsible for collecting and hosting data has little, if any, capability to verify the information being received.

Moreover, the Financial Action Task Force Recommendations on Anti-Money Laundering only mentioned the "more than 25 percent threshold" as an example benchmark. If a company has no apparent UBOs (because all shareholders are below the threshold), then legislation could be made clear and unambiguous, requiring either the lowering of the threshold or requiring registration as UBOs of all of the main shareholders because they should all be considered to have significant influence over the entity. Other countries have lower thresholds[1]:

- Argentina: 20 percent;
- Bermuda: 10 percent;
- US: 5 percent;
- Switzerland: 3 percent;
- Burkina Faso: no threshold;
- Ghana: no threshold;

- Honduras: 5 percent; and
- Kyrgyz Republic: 5 percent (or no threshold for politically exposed persons).

Discretion in EU law

Whilst trying to plug the various loopholes in EU jurisdictions that criminals exploit, EU lawmakers have left at member states' discretion key aspects of defining who its laws should regulate. The source of discretion is to be found in article 288 of the Treaty on the Functioning of the European Union, establishing that member states may choose implementation forms and methods when applying a directive while having to live up to the latter's objectives. Both MLD4 and MLD5 indicate that member states have some latitude as they may choose to adopt stricter measures than those laid down by the directive. In addition, both directives grant Member States the latitude to draw their own conclusions on which entities should fall within the scopes of MLD4 and MLD5. For instance, Article 1(16)(a) of MLD5 widens the registration requirement to include legal arrangements having a structure or functions similar to trusts. The proposed amendment lets EU countries decide which local structures are similar to trusts and should be subject to trust regulations. It appears that if a country decides that such a structure is not like a trust (or like a company), it may not need to register. This seems problematic considering current cases of non-compliance with even explicit MLD4 requirements, with a number of countries failing to meet the timeframe to transpose MLD4 into national law. The opportunity for discretionary decision-making and scope for own interpretation, judgement and choice is therefore ripe for the creation of oversights and gaps.

Both for registration of companies and trusts, MLD5 states that member states shall ensure that breaches are subject to effective, proportionate and dissuasive measures or sanctions. Sanctions should not be subject to discretion. Only one sanction could apply: if a legal vehicle (company, entity, trust, etc.) has not registered its UBO as required by MLD5, then that entity should not be allowed to incorporate (and legally exist) or to operate in the EU.

Conclusion

These registers are potentially good news for law firms, compliance officers and heads of risk. A primary requirement, and administrative burden of CDD at the moment is identifying UBOs. Access to a

pan-European register, as envisaged under MLD5, will likely make CDD research much easier.

However, systemic problem areas exist in the EU's UBO register legislation. These include its inherent unreliability (evidenced in some of the data published by the UK's Companies House), the current gap in the regulatory fabric with the consequence that the information is unverified, as well as the misconceptions in the interpretation of the legislation. The increased accessibility of the registers is contributing to deliberate obfuscation. Of course, there is also the possibility that increasing UBO requirements will deter the use of EU companies in favour of those corporate regimes where similar UBO registers do not exist and distort business decisions. Evidently, whilst public register perfection is not intangible, it continues to remain elusive.

Reference

1. Source: EITI 2015 Beneficial Ownership Pilot Evaluation Report, pages 6-10.