

Hurdles Remain As UK Pushes On With AML-Fighting Register

By **Najiyya Budaly**

Law360, London (March 8, 2019, 7:34 PM GMT) -- The U.K. has a headstart on implementing the latest round of European rules designed to clamp down on money laundering, with its two-year old public register showing who really owns corporate entities. But the government faces challenges if it wants the British version to be effective in helping to cut back criminal funding.

European Union anti-money laundering laws have since 2016 required countries in the bloc to maintain a central register of the so-called ultimate beneficial owners behind legal entities — those holding 25 percent or more of shares. But the EU's fifth Anti-Money Laundering Directive goes a step further in the wake of a series of scandals and leaks, mandating that the registers held by member states must be linked and made public instead of being accessible only to regulators. The directive entered into force in 2018, and member states will need to transpose it into their rulebooks by January 2020.

Britain had already gone beyond the EU's requirements in 2016 by setting up the world's first fully open register of "persons with significant control" under the auspices of Companies House, the government's registrar of companies.

Lawyers say this paves the way for greater public accountability for company owners. But the success of the register depends on whether the government will ensure that companies are using it correctly and whether Companies House will be able to keep it accurate and up to date. The government will also have to manage conflicting requirements of U.K. company law.

"If the legal framework is observed and enforced the PSC register will be incredibly powerful," said Ian Hargreaves, a partner at Covington & Burling LLP. "Without verification and proper review, though, people will get around this."

The register is only as good as the people using it

Lawyers believe that the U.K. register functions because its public nature deters companies from recording false information, which makes assets easier to trace. But the procedure for submitting ownership details to Companies House is fraught with loopholes that criminals can exploit.

Abdulali Jiwaji, a partner at boutique law firm Signature Litigation LLP, said the register is a move in the right direction: It encourages companies to meet the statutory obligation to be transparent about their ownership. And it aids lawyers by ensuring that company assets are traceable.

“These registers are helpful during litigation cases, if we are trying to go after assets, to know what the connections are between different organizations,” Jiwaji said.

But the register can be exploited. Advocacy group Global Witness has said that thousands of individuals have sold their personal details to allow companies to record them as their beneficial owner. The group said in July that it had found 9,199 individuals were recorded as each owning more than 100 companies.

“Practitioners conducting internal investigations are familiar with a roster of about 20 different nominee directors,” White & Case LLP partner Jonathan Pickworth said. “They weren’t super-criminals, they were yoga teachers from Cyprus or basketball players from Latvia who had sold their identity. These nominees are not currently appointed as directors in the way they were in the past.”

Lawyers fear there are still deliberately false entries in the database. The U.K. will have to tackle this under the AML regime, which requires that information must be “adequate, accurate and current.” And Jiwaji worried that companies can still withhold information.

“The register is as good as the people using it and to the extent that breaches can be sanctioned,” Jiwaji said.

Companies can also exploit loopholes in the register, according to Hogan Lovells partner Claire Lipworth. Because only those individuals holding a 25 percent or greater stake in shares must be registered, businesses can conceal beneficial owners by ensuring they have a smaller stake.

“Ten percent of companies don’t have an [ultimate beneficial owner] because of the threshold,” Lipworth said. “If they’re not followed up on then that’s a real deficiency.”

And some U.K. companies have listed businesses based in tax havens as the person with significant control. Global Witness found in July that 10,000 companies on the register listed an overseas firm as their beneficial owner — and almost three-quarters, 72 percent, of these were linked to countries with weaker transparency laws.

Lawyers also pointed out that it is not difficult to create a company in the U.K. without setting foot in Britain.

“The ability to perform formation and filing functions online means that unregulated individuals and firms, potentially based overseas, can quickly and easily form companies and LLPs in the U.K. electronically,” Pickworth said.

Companies House isn’t a regulator

Companies House does not have the authority or sufficient funds to police companies that fail to comply with their reporting obligations, lawyers say.

“One of the big criticisms with the way in which the PSC register was introduced is that Companies House is not a regulator, so it does not review or verify the quality of the information it is receiving in the same way that a regulator would,” Covington's Hargreaves said.

But the issue ultimately is money, he said.

"With more financial support, individuals can be employed to review the content and alert any red flags," Hargreaves said. "But that costs money and most government agencies, notwithstanding the recent budget, are strapped for cash."

Additionally, sniffing out incorrect information may prove difficult for an executive agency without investigative expertise, according to Jiwaji.

"Unless someone is sitting down and analyzing the information in detail, it may become difficult to identify failures to comply," Jiwaji said. "It's probably going to be a stretch for someone at Companies House going into it cold."

Indeed, in-depth investigations into whether a business has submitted false details usually spring from an existing case, such as during litigation proceedings or tax checks, Jiwaji noted.

"My feeling is that when you're looking at the set-up of a company for a particular purpose, like during litigation, that's when you may start identifying gaps," Jiwaji said.

Striking a balance

As it polices the register, the government must weigh public security needs against the risk of deterring foreign investment with measures that could suppress economic growth.

"The U.K. regime is seen as fairly liberal and business-friendly, particularly by overseas formations agents," White & Case's Pickworth said, referring to services that help individuals incorporate and register their company in Britain. "The U.K. government has to try to strike a balance between preventing abuse of our regime and making it easy for legitimate business persons to start a new business."

And, as Britain prepares to leave the EU later in March, it will need to set itself apart from other countries to attract global investors, Hargreaves said. Britain has achieved this in the past through relaxed rules in its overseas territories, but introducing stringent requirements on transparency and disclosure could deter companies from opening in these regions.

"I fear for what may happen post-March 2019 if we are in a 'no deal' scenario," Hargreaves said. "We're going to have to differentiate ourselves."

But the government can take steps to improve the register even as it seeks to attract foreign business. Hargreaves maintains that there is no such thing as "over-regulating" this area.

There is also a balance to be found between data protection and privacy, Hargreaves added. The register may be perceived to be in conflict with EU data protection rules because much of the information in the register is personal and sensitive.

But Jiwaji said this is the price company directors pay for the benefits they enjoy.

"If you want to take advantage of that structure you have to be prepared to give up a little privacy," Jiwaji said.

Fixes wouldn't take rocket science

Even with Brexit looming, the U.K. government may have an incentive to close loopholes, particularly as it considers the requirement in the AML directive for “adequate, accurate and current” information.

“The fifth directive, if something similar is implemented in the U.K. following Brexit, will address some of the outstanding issues,” Hargreaves said. “It would not take rocket science for the changes to be made, which would result in a more effective register of beneficial ownership.”

Regulators, non-governmental organizations and the wider community could pick up on anomalies, errors and dishonest entries because all EU registers will be accessible to the public under the updated rules, Hargreaves said.

Jiwaji likewise noted that greater public scrutiny will force companies to comply with the measures.

“The concept of public access will change, and there will be groups who are interested in policing this from a public interest perspective,” he said. “This will lead to more transparency and examples where information needs to be corrected.”

Linking all member states’ registers by 2020 will also create a web that will help investigators track down the source of terrorist funding, Hargreaves said.

“The Panama Papers exposed that terrorist financing can be hidden in complicated financial and corporate structures, and we need to find a way to trace these assets,” he said.

But it will take time before the effect of the new EU rules on the U.K.’s register can be seen, and the government cannot be expected to change too much immediately, Lipworth said.

“It’s very difficult to get these frameworks right and they need to be adjusted,” she said. “Sometimes you can’t crystal-ball-gaze in advance to see what you need to tighten.”

--Editing by Melissa Lipman and Ed Harris.