Investigations · Compliance Solutions · Cyber Defense

06 MAY 2020

Beneficial Ownership: Current Challenges Met with Opportunity

Beneficial ownership is a topic which presents significant challenges to compliance officers charged with untangling a web of ownership interests that span numerous international jurisdictions and ownership structures. As of May 2018, covered financial institutions, including banks, are required to establish and maintain written procedures designed to identify and verify beneficial owners of legal entities. Approaching two years on from the implementation of this law, the Financial Action Task Force's (FATF) March 2020 report on AML and CTF measures in the United States, stated that with regards to customer due diligence requirements to ascertain and verify the identity of beneficial owners "the U.S. has addressed a number of the key identified deficiencies, but deficiencies (especially in relation to all types of legal arrangements) still remain."

As the rule has now been mandated as an active part of financial institutions' compliance programs for nearly two years, financial institutions may find that federal and state examiners take particular interest in beneficial ownership compliance during their examinations, as they remain acutely aware of the impact noncompliance with the rule has on the ability to identify illicit activity and to be in full compliance with FATF recommendations. Given that financial institutions have had adequate time to implement and test their processes as it relates to compliance with the beneficial ownership rule, together with growing attention on the matter from global AML organizations, examiners may take notice and seek to ensure these institutions are compliant. Simply put, the ramp up period has passed, and beneficial ownership compliance will now be table stakes.

It is crucial for financial institutions to have a defined structure in place to comply with the Beneficial Ownership Rule in order to assist authorities in combatting financial crimes and to improve financial transparency by preventing criminals and terrorists from misusing companies to disguise their illicit activities and launder their ill-gotten gains.

Key Challenges

With the current guidance in mind, one of the prevalent challenges faced by compliance officers is identifying beneficial ownership when the legal entity is established in tax havens and opaque jurisdictions (AKA offshore jurisdictions). While the United States, the UK, and the EU require full disclosure of ownership, this is not always matched by many other jurisdictions.

Equally challenging is the ability to identify the ownership share (percentage) of each relevant individual, as countries' or states' registrars of companies, as well as other data sources, may be able to establish ownership yet be incapable of specifying precise percentages. Additionally, some ownership links may be undisclosed, while others may simply state that the company is majority.owned.

Developing a Standardized and Reasonable Approach

With lack of transparency at the core, juxtaposed with varying holding structures and ownership that becomes more diluted, how can compliance professionals establish beneficial ownership and control at companies? U.S. regulators are typically looking for financial institutions to apply a standardized and reasonable approach to identifying ownership, and there are several ways that financial institutions can protect themselves from regulatory scrutiny.

Gradually, organizations are moving away from periodic reviews of beneficial ownership and progressing toward continual assessment, by automating and systematizing the ongoing monitoring of customer and third-party due diligence.

By implementing continual assessments, it is possible to unearth client-counterparty risk and detect risks faster. Other benefits include a level of consistency not provided by manual reviews, particularly when driven by automation; rules to resolve hidden complexities; and the potential to reduce costs and time. Monitoring and continuing assessment on true ownership, from both an equity interest and a control perspective, has proven challenging to manage with all the ongoing regulatory developments and requirements. But by asking the right questions and leveraging the proper tools, there is an opportunity.

Beneficial ownership needs to be treated like any other assessment criteria, and should be perceived in the framework of three simple questions: first, how can it be known if there has actually been a change? Second, how can it be established what that change actually was? Third, how has the change impacted the business, its customers, or its policies?

There are four main steps that are key for addressing beneficial ownership properly. First, always seek to improve the approach—it's impossible to predict all changes in this area, and therefore it's important to adopt an open design with flexibility to add new metrics and extend categories, such as share voting rights and the ability to appoint directors and authorized signatories. For example, lowering the threshold for identifying ownership to 10 percent from the usual 25 percent for certain high-risk jurisdictions or customer types.

Second, take a systematic approach that is consistent in terms of calculating ownership and control. Use a risk-based approach that divides clients into three categories of risk—high, medium, and low—and tackle the "high risk" first to minimize exposure.

Third, understand the complexities of identifying and monitoring ownerships. Compliance officers could be following ownership, control, or other future metrics, which could each stretch out into hundreds of relationships. To this point, it is advantageous to develop standardized research procedures for specific jurisdictions that have a high risk of corruption. This will vastly improve efficiency in identifying ownership while, again, minimizing exposure to risk.

Finally, be prepared to embrace emerging technologies, such as visualization tools, which can simplify and provide ownership structure in one diagram instead of multiple written paragraphs, and consider how these technologies can fit into existing processes and feed existing screening mechanisms.

While beneficial ownership requirements may still pose a great challenge, it is important to remember that regulators are always looking for documentation. Each of these steps will be most effective when accompanied by explanations that give regulators a roadmap to understanding how the procedures, rules, and technology serve to create a reasonable, standardized and comprehensive approach to identifying the beneficial ownership for legal entity customers.