EUROPEAN COMMISSION PROPOSAL ON AMLD4

QUESTIONS AND ANSWERS

INTRODUCTION

On 5 July 2016, the European Commission published a legislative proposal to amend the fourth Anti-Money Laundering Directive introducing a number of changes to enhance the transparency of the EU financial system following the Panama leaks, including new requirements on certain companies and trusts to publicly disclose information on their beneficial owners.[1]

We consider that the changes announced by the European Commission are a positive step towards greater transparency. In particular, we welcome the European Commission's recognition that public access to BO information is crucial in the fight against tax fraud and money laundering. However, we strongly believe that further changes are necessary. As this Q&A shows, there are a number of ways in which the proposal needs to be amended in order to enhance financial transparency in the European Union.

1. What are the problems revealed by the Panama Papers? Are opaque company structures and other legal entities frequently abused by criminals?

The Panama Papers clearly demonstrate that opaque company structures and trusts were abused by criminals to conceal their identity from public authorities.

The 11 million leaked document from the Panamanian law firm Mossack Fonseca allowed journalists to take a closer look at the owners and structures of more than 200,000 companies based in offshore secrecy jurisdictions around the world. By setting up opaque company structures such as shell companies and trusts, Mossack Fonseca assisted their clients in concealing their identities from tax authorities and thereby evading taxation. One leaked memorandum from a partner of Mossack Fonseca said that "ninety-five percent of our work coincidentally consists in selling vehicles to avoid taxes."[2] Analysis by Europol, the EU's law enforcement agency, shows that almost 3,500 individuals and companies identified in the Panama Papers are probable matches for suspected criminals involved in terrorism, cyber-crime, cigarette smuggling and other crimes.[3]

While trusts have legitimate uses such as estate and inheritance planning, it is clear that they are frequently used for illicit purposes. The Financial Action Task Force (FATF), an intergovernmental anti-money laundering body, states that trusts are frequently seen by "criminals as potentially useful vehicles" to retain control over criminally derived assets "while frustrating the ability of law enforcement to trace the origin and ownership of the assets."[4] The World Bank, in its landmark study 'Puppet Masters', meanwhile writes that "[i]nvestigators and prosecutors tend not to bring charges against trusts, because of the difficulty in proving their role in the crime."[5] Until these structures are included in public registers, there will always be ways for money launderers and tax dodgers to hide and escape the requirement to pay taxation.

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[1] European Commission. Commission strengthens transparency rules to tackle terrorism financing, tax avoidance and money laundering. http://europa.eu/rapid/press-release_IP-16-2380_en.htm

[2] The Guardian. The Panama Papes: how the world's rich and famous hide their money offshore. https://www.theguardian.com/news/2016/apr/03/the-panama-papers-how-the-worlds-rich-and-famous-hide-their-money-offshore

[3] The Guardian. Panama Papers: Europol links 3,500 names to suspected criminals. https://www.theguardian.com/news/2016/dec/01/panama-papers-europol-links-3500-names-to-suspected-criminals?CMP=Share_AndroidApp_Outlook

[4] "Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals", Financial Action Task Force, June 2013, p. 54

[5] "The Puppet Masters: How the Corrupt Use Legal Structures to Hide Stolen Assets and What to Do About It", World Bank, 2011.

2. Will the European Commission's legislative proposal ensure that all the beneficial owners of a company are identified?

No. The European Commission's proposal maintains a high ownership threshold of 25% for most companies, with a 10% threshold for high-risk companies called passive non-financial entities. We believe this threshold should be lowered to at least 10% for all companies.

We believe that the 25% threshold to be considered a BO of a company is too high a threshold that can be easily exploited by people looking to stay under the radar. The European Commission assesses in its own impact assessment that the "25% threshold is fairly easy to circumvent, leading to [the] obscuring of [...] beneficial ownership [information]."[6] With a typical family consisting of four individuals, the threshold is indeed very easy to circumvent. By illustration, in a case where four family members have an equal ownership of a firm, no one would trigger the threshold of more than 25% ownership to be considered a beneficial owner. Lowering the threshold to 10% would make it more difficult to appoint a few trusted individuals as shareholders. A data dive into the UK's open data register on beneficial owners of companies by Global Witness, revealed that nearly 1 in 10 companies "claimed to have no beneficial owner" at all and that this is possible under the legislation "because you have to own at least 25 per cent of a company to be considered its beneficial owner."[7]

There is precedent for setting the threshold at 10%. For the purposes of the United States Foreign Account Tax Compliance Act (FATCA), a US law aimed at preventing tax evasion by US taxpayers, a substantial US owner of a company is considered any US person who owns, directly or indirectly, more than 10% of the stock of the corporation by vote or value.[8] Precedents for even lower thresholds exist as well. Several EITI countries had a pilot BO project for extractive companies where four countries had no threshold at all and three used a threshold of 5%.[9] In the US, the Securities and Exchange Commission requires all individuals to disclose their status as a beneficial owner when they reach directly or indirectly the threshold of 5%.[10]

One of the main arguments against creating BO registers or lowering the threshold is that companies would find it very difficult to identify their beneficial owners, but analysis by Global Witness shows that this is not the case in the United Kingdom: "in only 2% of cases did companies say they were struggling to identify a beneficial owner or collect the right information."[11]

3. Will the European Commission's legislative proposal solve the problem of appointed nominee directors being identified as beneficial owners?

No, under the European Commission's proposal, if no BO can be identified, a senior managing director can be listed as a beneficial owner instead thereby avoiding the transparency of the actual owners.

This is a serious loophole which allows 'nominee directors' (individuals often nominated by offshore law firms who have no real control over the firm in question) to be listed as beneficial owners of a company. The presence of nominee directors and shareholders should be considered a red flag during anti-money laundering risk assessments, and measures are needed to ensure that nominee directors are always identified and titled as such. The FATF specifically recommends in its 2012 guidance that steps are needed to prevent the misuse of nominee directorships used to disguise the beneficial ownership of companies. One of its key recommendations to member countries is that nominees should be disclosed "to the company registry that they are nominees."[12] We believe

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[6] European Commission. Impact Assessment accompanying AMLD4: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52016SC0223

[7] Global Witness: What Does the UK beneficial ownership data show us? https://www.globalwitness.org/en-gb/blog/what-does-uk-beneficial-ownership-data-show-us/

[8] Internal Revenue Service: https://www.irs.gov/pub/newsroom/reg-121647-10.pdf, p. 346.

[9] https://eiti.org/sites/default/files/documents/BP/board_paper_30-4-b_beneficial_ownership_pilot_-_evaluation_report.pdf

[10] https://www.sec.gov/answers/sched13.htm

[11] Global Witness: What Does the UK beneficial ownership data show us? https://www.globalwitness.org/en-gb/blog/what-does-uk-beneficial-ownership-data-show-us/

[12] FATF. Guidance on Transparency and Beneficial Ownership. http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-transparency-beneficial-ownership.pdf

that the Proposal should be amended so that if a company cannot identify a beneficial owner, then an explicit public statement about this fact should be disclosed in the register. The relevant natural person who holds the position of senior managing official should also be identified as a 'senior manager' in the public register, and not as a 'beneficial owner' as under the current Proposal.

4. **Will the European Commission's legislative proposal ensure that all companies having formal business activities in the EU have to register their BOs?**

No. Only companies incorporated in the EU Member States have to register their beneficial owners. This means that foreign companies owning real estate in the EU wouldn't have to register their true owners.

It is possible for foreign companies to buy real estate in the EU or hold a bank account in a European bank. In some countries this is actually a very common phenomenon. A report by Transparency International shows that, in London alone, 36,342 properties covering 2.2 square miles (5.7 square kilometres)– an area twice the size of London's financial district – are owned by shell companies.[13] 75 per cent of UK properties that are currently being investigated because of corruption are registered in secrecy jurisdictions.

Credit and financial institutions, as well as real estate agents, have to perform due diligence and know-your-customer procedures in order to assess the risk of money laundering. Requiring foreign entities to register, and comply with the same transparency requirements as the EU companies and publicly declare beneficial owners and their corporate structure, would help obliged entities to perform their due diligence requirements with regard to foreign entities.

Investigations related to the Panama Papers, and subsequent declarations from several offshore jurisdictions show clearly that there is no political commitment from several well-known secrecy jurisdictions to establish public registers of beneficial owners. By requiring non-EU firms with formal business ties to the EU to disclose BO information, the EU register could have a truly global impact on the transparency of corporate entities, combating offshore activity not just in the EU, but throughout the world.

5. **Will the European Commission's legislative proposal ensure that all trusts involving EU persons are required to register their beneficial owners? Will the provisions on trusts proposed by the European Commission address the problems exposed by the Panama Papers?**

No. The scope of the European Commission's legislative proposal is very narrow, and only requires trusts which have trustees based within the European Union to register the beneficial ownership in a central register. This is a serious loophole which can be easily circumvented by appointing a foreign trustee from a country that does not require public registration of BO information.

Under the Commission's proposal, trusts active within the European Union (e.g. by having an EU resident settlor, EU resident beneficiaries or holding EU assets), yet with a trustee based outside the European Union (e.g. in Panama) would not be covered. This is a very narrow scope which would omit the vast majority of cases exposed by the Panama Papers involving offshore trusts, mostly managed by trustees based in non-European countries such as Panama and the Bahamas. It would also mean that a lot of trust structures with material consequences in EU Member States would not be covered.

We believe that the scope of the European Commission's proposal should be widened in order to ensure that all trusts with any connection point to an EU country, such as having a resident settlor, protector, trustee, beneficiary, or assets within the territory of the EU, should be required to register their beneficial owners in the EU registers.

6. **Should there be a blanket exemption for non-commercial trusts from public reporting requirements as proposed by the European Commission? Is it enough to grant access to those with a legitimate interest?**

[13] Transparency International: Property in the UK - a home for corrupt money. http://www.transparency.org/news/feature/property_in_the_uk_a_home_for_corrupt_money

We believe that the distinction between commercial and non-commercial trusts will be difficult to make in practice, and excluding non-commercial trusts from public reporting requirements could lead to new loopholes. All trusts should be required to publicly report information on their BOs.

Under the current Proposal, access to BO information on non-commercial trusts will only be accessible to those with a legitimate interest. There are several problems with this approach. Firstly, the distinction between commercial and non-commercial trusts will be difficult to make in practice. No such typology differentiation between commercial and non-commercial currently exists in trust legislation, and criminals will exploit this ambiguity in order to avoid public disclosure requirements. Secondly, non-commercial trusts were also implicated in recent scandals including the Panama Papers and therefore should not benefit from a blanket exemption.

Determining who has a legitimate interest in accessing this data and who does not has also proven to be difficult to assess by EU Member States when implementing AMLD4. For instance, the Dutch Government concluded that the legitimate interest would be "hard to control, hard to enact, and costly" and therefore decided to make its registers fully public.[14] Other Member States, meanwhile, have interpreted legitimate interest in such a restrictive sense that it would be very difficult indeed for legitimate parties, such as NGOs, to gain access to the registers. The European Commission warns in its own impact assessment that the "legitimate interest left to national discretion may lead to excessive limitations of the access to the register as well as to a lack of a level playing field" between Member States.[15] We believe that in a well-functioning internal market, there is a need for a coordinated approach in order to avoid such distortions.

There is a strong case for full public disclosure. Public scrutiny would act as an important deterrent for illicit activities. Public registers give opportunities to a wide range of stakeholders to spot inaccurate information and to make it more difficult for criminals to lie about their beneficial ownership. Money laundering and tax evasion are cross-border crimes, and making this information available publicly will make it much easier for tax authorities and relevant financial institutions from non-EU countries to fight against the misuse of legal entities.

Transparency in beneficial ownership information also helps businesses to understand who they are doing business with. A recent survey by professional services firm EY reveals that 91% of business leaders believe that it is important to know the ultimate beneficial ownership of the entities that they do businesses with.[16] In September 2016, a group of investors representing more than $740bn in assets under management, expressed strong support in a letter to US Senators calling for requirements on companies to disclose their BO information, explaining that opaque company structures are not only an obstacle for law enforcement, but also "inhibit investors' ability to identify risks" and thereby negatively impact shareholder value.[17] Knowing who you are investing in or trading with helps firms to make more informed investment decisions, and can reduce companies due diligence and legal costs. Knowing whether a corrupt politician is the beneficial owner of a potential partner can also help companies to avoid the risk of violating anti-corruption laws. As the UK authorities put it: "Corporate opacity ... damages the business environment."[18]

7. **Are trust beneficiaries predominantly vulnerable individuals that should be guarded against unwanted attention? Should there be exemptions for information about certain individuals to be public?**

We believe it is important to introduce a robust protection regime, however blanket exemptions create loopholes that could be misused.

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[14] Financial Transparency Coalition. Dutch government plans to grant public access to beneficial ownership register. https://financialtransparency.org/dutch-government-plans-to-grant-public-access-to-beneficial-ownership-register/

[15] European Commission. Impact Assessment accompanying AMLD4: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52016SC0223

[16] E&Y. Global Fraud Survey 2016. http://www.ey.be/gl/en/services/assurance/fraud-investigation---dispute-services/ey-global-fraud-survey-2016

[17] Global Witness. Investors managing over $740 billion call for transparency over company owners. https://www.globalwitness.org/en/press-releases/investors-managing-over-740-billion-call-transparency-over-american-company-owners/

[18] UK Government. Explanatory Memorandum to the Register of People with Significant Control Regulations 2016, page 2. http://www.legislation.gov.uk/uksi/2016/339/pdfs/uksiem_20160339_en.pdf

The Commission's proposal says that in exceptional circumstances, where public access would expose beneficial owners to the risks of "fraud, kidnapping, blackmail, violence or intimidation" or where the BO is a minor or otherwise incapable, Member States may provide exemptions from disclosing information on a case-by-case basis. [19] The Panama Papers have clearly demonstrated that the most egregious criminals will not shy away from using their own or others' children as scapegoats when hiding their ownership of shady business arrangements.

In order to prevent this, exemptions should be reviewed on a case-by-case basis. Vulnerable trust beneficiaries should be allowed to opt-out from public reporting requirements following an official request to their respective competent authorities. This would have to be a tightly defined protection regime developed by each Member State that people would have to specifically apply for, in order to prevent that this option turns into a blanket exemption for all people who think that they are vulnerable. When an exemption is made, this should be made clearly visible in the register available to the public. This would allow those looking at the register to realise they are seeing an incomplete picture, and – when in doubt – to challenge the exemption with the competent authority.

There is a precedent for this approach in national law. In the United Kingdom, if a trust wants to claim special tax treatment in the UK because it is a 'trust for vulnerable beneficiaries', the trustee has to fill a 'Vulnerable Person Election' form and send it to the HMRC to be assessed. A similar approach could be used for trusts having a vulnerable BO. The UK already has a measure in place for company BOs to request restricting disclosure of their information to the public if they are at serious risk of violence or intimidation. Analysis by Global Witness, shows that this approach works, and that in the United Kingdom approximately "30 beneficial owners have been successfully granted the right to keep their name of the register due to concerns about their security." [20]

8. Would public disclosure of beneficial ownership information violate the right to privacy?

The recent leaks have demonstrated that the anonymity of companies and trust have a detrimental impact on tax authorities capacity to collect the tax revenue they are due. The right to privacy must be balanced against the need to prevent financial crime.

Anonymous companies and trusts have an impact on everyone in society, and we believe that the Panama Papers demonstrate that everyone should be able to access this kind of information. The Court of Justice of the European Union ruled in 2012 that the right to protect personal data should be considered in relation to other societal interests and balanced with other fundamental rights, in accordance with the principle of proportionality. [21] In other words, the right of people to keep their financial affairs secret must be balanced against the need of society to prevent financial crimes and personal data should only be made public when it is justified or necessary for a legitimate purpose.

We believe that public disclosure is a necessary and proportionate response to prevent the abuse of trusts. Tax authorities alone were not able to uncover the financial abuses revealed by the Panama Papers, and it was left to investigative journalists and civil society to uncover the wrongdoings that were revealed by the Panama leaks. At a time of public austerity, which has resulted in 50,000 staff cuts in national tax authorities across Europe [22], tax authorities do not have the capacity to assess all of the potential abuses and mistakes hidden in the central registers. Europol, in written evidence to the PANA Committee, explained that "a common problem across member states in tackling money laundering and conducting financial investigations is lack of resources." [23] Making

[19] European Commission. Directive amending AMLD4. http://ec.europa.eu/justice/criminal/document/files/aml-directive_en.pdf
[20] Global Witness: What Does the UK beneficial ownership data show us? https://www.globalwitness.org/en-gb/blog/what-does-uk-beneficial-ownership-data-show-us/
[21] "Safeguarding Privacy in a Connected World: A European Data Protection Framework for the 21st Century," Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, January 25, 2012.
[22] A report by EPSU in 2013 revealed that 50,000 jobs were cut in EU national tax authorities in the four years after the financial crisis. EPSU: Impact of austerity on jobs in tax services and the fight against tax fraud and avoidance in EU-27. http://www.epsu.org/sites/default/files/article/files/LayoutTax_collection_services_report_Final_-_EN.pdf
[23] European Parliament. Replies to written questions from Simon Riondet, Representative of Europol and FIU Network. https://polcms.secure.europarl.europa.eu/cmsdata/upload/9b010278-60f1-4de8-b3df-f45227b09d5c/Riondet%20EUROPOL%20replies%20to%20questionnaire%20-v1-Panama_Papers_QAs%20(2).pdf

this information publicly available would allow a wider range of stakeholders to investigate and verify the accuracy of the claims made in the registers.

As an example, Global Witness was able to carry out a data analysis of the UK public register for companies, which revealed a number of inaccuracies, including 3,000 companies with tax haven addresses listed as BOs (against the rules). Their findings also suggest 19 politically exposed person, 76 people from the US sanctions lists and 27 disqualified directors were listed as beneficial owners.[24] Public scrutiny will allow interested parties to analyse such information in novel ways and share the work burden of tax administrators in the process.

In exceptional circumstances, trustees/settlors should be allowed to request to national authorities not to make that information about the trust or legal arrangement in question publicly accessible, for the purpose of protecting the privacy of vulnerable beneficiaries. It should also always be possible to challenge such decisions.

9. Does the European Commission's proposal ensure that the data will be open and easily accessible?

No. The proposal envisages the possibility for levying fees in order to cover the costs associated with the registries. We believe that this is a serious limitation that will reduce the effectiveness of the registers and diminish the ability of civil society and other interested individuals to scrutinise them and detect instances of misdoings.

We believe that the public registers should be based on accepted open data standards in order to ensure unhindered usability and the transparency of the data. A file format based on these standards is platform independent and made available to the public without any restriction that impedes the re-use of the documents. When companies use extremely complex ownership structures with numerous layers of control, it becomes prohibitive to pull costly records for each of the entities in order to fully grasp the ownership structure. Open data would give journalists and civil society organisations a cost-effective way of monitoring tax avoidance practices; sharing the work burden of tax administration for doing so in the process.

Open data is also more cost-efficient than a system that is based on information requests and is more in line with the European Commission's longer term goal to interconnect all BO registers in Member States. The UK Companies House already has an up and running company BO register that adheres to these Open data standards (with some restrictions). In this video, Companies House says this "can only be good for the economy" as it saves costs, promotes innovation and helps everyone make better informed decisions.[25]

[24] Global Witness: What Does the UK beneficial ownership data show us? https://www.globalwitness.org/en-gb/blog/what-does-uk-beneficial-ownership-data-show-us/

[25] Companies House. Launch of the new Companies House public beta service. https://www.youtube.com/watch?v=27CT4m4-DJk