Part 2. The Beneficial Owner

"The secret to success is to own nothing, but control everything."

—Nelson Rockefeller

2.1 Introduction

In Part 2, we focus on the beneficial owner(s)—the person (or group of people) who have an interest in or control over ill-gotten gains (property or financial assets) and who are trying to conceal the fact through the misuse of corporate vehicles.

For our purposes, this concealment can be viewed from two angles:

- The narrow perspective of the service provider
- The broad perspective of the investigator.

Service Providers

Service providers normally face the question of who is the beneficial owner of certain assets when first entering into a relationship with a customer. They normally approach the matter by looking first at the legal structure of the customer's entity or arrangement. They have certain facts and documents at their disposal, at least some of which have been provided by the customer, but this is only part of the information they need. Exactly how accurately the information available to them reflects the economic reality of control will become apparent (to a degree) during the course of their business relationship with the customer. In other words, the information available to service providers is highly partial and incomplete.

Investigators

By contrast, when investigators become involved in a case, they already are looking at a wider constellation of facts. They know (or at least strongly suspect) that they are looking at a scheme that has been designed to create an appearance of legitimacy, when in fact, it is a facade. They no longer are deceived by that appearance.

It is important to remember these two different viewpoints as we examine how the various parties approach the problem of identifying the beneficial owners of corporate vehicles.

2.2 Origin of the Term "Beneficial Owner"

The concept of "beneficial ownership" originated in the United Kingdom (see box 2.1). During the development of trust law, the following distinction between two types of ownership—"legal ownership" and "beneficial ownership"—was introduced:

> The legal ownership of the trust-property is in the trustee, but he holds it not for his own benefit but for that of the *cestui que trustent* or the beneficiaries. On the creation of a trust in the strict sense as it was developed by equity, the full ownership in the trust property was split into two constituent elements, which became vested in different persons: the "legal ownership" in the trustee, and what became to be called the "beneficial ownership" in the *cestui que trust* [that is, the beneficiary].[7]

Although the term "beneficial owner" currently is applied in a wide variety of situations that do not involve trusts, the essence of the concept—as referring to the person who ultimately controls an asset and can benefit from it—remains the same. Indeed, in discussions with investigators, the typical response to the question of how to find the beneficial owner is the simple answer so often heard in criminal investigations: "Find out who benefits." The image of someone absent, temporarily abroad but able to retake his lands at any time, provides a helpful illustration of the idea of beneficial ownership, because it reveals not only that he is the one who benefits but also that he is the one who exercises control in the end—not directly and overtly, but indirectly and covertly, invisible to the outside world. This characteristic is essential to the concept of beneficial ownership, certainly as it applies to criminal situations. The beneficial owner may not be on the scene, and it may *appear* that the lands belong to someone else. However, in the final analysis, they are his.

BOX 2.1 The Origin of the Trust

Although the precise historic origins of the trust are uncertain, they were in use in the 12th century during the time of the Crusades:

> Typically the warrior would be away from England for some years and therefore needed his land tended in his absence. It was essential that the person who was left in charge could exercise all of the powers of the legal owner of that land, such as deciding who would farm which part of the land and collecting taxes. However, the crusader wanted to ensure that he would be able to recover all of his rights of ownership when he returned from the war. Consequently, the idea of split ownership of the property emerged, whereby the crusader was treated as the owner of the land by the courts of equity and the person left in charge was treated by the common-law courts as being owner of the land.[a]

Note: a. See Alastair Hudson, *Equity and Trusts,* 4th ed. (London: Cavendish Publishing, 2005), p. 35.

[7] Lord Diplock in *Ayerst (Inspector of Taxes) v C&K (Construction) Ltd*, H.L. (1975) S.T.C. 345.

2.3 Defining Beneficial Ownership: The Theory

The internationally accepted definition of beneficial ownership, which may usefully serve as the starting point of this discussion, is the one given by the FATF. It reads as follows: "Beneficial owner refers to the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement."[8]

Before discussing the details and implications of this definition, it is useful to clarify a terminological point, specifically the use of the terms "customer" and "transaction" in the first sentence of the definition. The FATF definition was developed in the context of a bank or other service provider dealing with a prospective customer and having an obligation to establish the identity of that potential customer's beneficial owner before carrying out any transactions on its behalf. The definition does not intend to suggest that the "customer" is a natural person (see section 2.3.1).

2.3.1 Natural Person versus Legal Person

The first noteworthy (and only unequivocal) element in the definition is that a beneficial owner is always a natural person—a legal person cannot, by definition, be a beneficial owner. The definition therefore also speaks of "ultimate" control: A legal person never can be the ultimate controller—ownership by a legal person is itself always controlled by a natural person.[9]

2.3.2 Beneficial versus Legal Ownership

The defining characteristic of the beneficial owner of an asset is that he holds a degree of control over the asset that allows him to benefit from it. Whether he is the *legal* owner (that is, holds legal title to it) is irrelevant. The essence of beneficial ownership is precisely *not* ownership in the ordinary sense of the word—but rather control. Control and legal title often will lie in the same hands, but in the sorts of situations addressed in this report, that often is not the case. It is important, therefore, not to confuse beneficial ownership with legal ownership. Section 2.3.3 concentrates on the control and ownership of a *corporate vehicle*.

2.3.3 Control—What Is It and Who Has It?

The definition speaks of "the natural person(s) who ultimately . . . controls a customer." The concept of control is a difficult one, given the manifold ways in which it can be

[8] See Financial Action Task Force on Money Laundering, "FATF 40 Recommendations," p. 15, available online at http://www.fatf-gafi.org/dataoecd/7/40/34849567.pdf.

[9] One cannot quite say the same for ownership, because a foundation, for instance, is not "owned" by anyone.

exercised. What does exercising control of a corporate vehicle mean, exactly? Who ultimately controls a corporate vehicle? The answers to these questions depend on the situation. The legal form and actual structure of the corporate vehicle provide a useful starting point, but they do not give us the whole answer. Let us consider who may be said to exercise ultimate control in a number of different corporate vehicles.

Control in Companies

Our analysis of 150 grand corruption cases shows that the main type of corporate vehicle used to conceal beneficial ownership is the company, so let us consider this vehicle first. In a company limited by shares, three groups of people might arguably qualify as having ultimate control:

- The shareholders, who can exercise the voting rights attached to their shares to make changes in how the company operates
- The board of directors, who generally exercise a more immediate level of control over the company, according to terms setting forth their powers of control
- The executive officers (possibly), who exercise day-to-day control and de facto engage in the transactions and activities of the company.

All three parties hold some level of control. In most cases, the shareholders may be said to have the most control over the corporate vehicle. They represent the ultimate level of power, in that they are not controlled by others (assuming they are natural persons acting on their own behalf) and they typically can remove the directors and ultimately enjoy the financial benefits (that is, dividends and net worth) of the company.

Control in Trusts

Companies have a relatively straightforward structure—it is possible to point to the owners (the shareholders). But a significant number of alternative types of corporate vehicles are more problematic in this regard: they cannot be owned, and simply no position is equivalent to the shareholder. In the case of a trust, for instance, several people arguably could qualify as the beneficial owner:

- The *trustee,*[10] because he conducts the day-to-day management of the asset held in trust and could—if he wanted—dispose of it in any way he liked. He is, however, legally bound to act in the interest of the beneficiary as set out in the deed of

[10] The methodology for assessing the FATF recommendations ("the methodology") stipulates that, when identifying the *customer* who is a legal arrangement (such as a trust), service providers should obtain information concerning the trustees—that is, the trustee qualifies as/is identified with, the customer (see 5.4 (b) of the *Methodology for Assessing Compliance with the FATF 40 Recommendations and the FATF 9 Special Recommendations,* p. 16). When discussing the identification of the *beneficial owner* of a legal arrangement, the methodology stipulates that this includes identifying those who exercise ultimate effective control over a legal arrangement, which for trusts means "identifying the settlor, *the trustee* . . . and the beneficiaries." So the trustee is perceived as being both the customer and the beneficial owner, qualifying both as part of the trust (the customer) and its ultimate controller. (The same point, incidentally, can be made in connection with the director and companies. He similarly qualifies as/is identified with both the customer [company] and—arguably—as part of its "mind and management" and thus as its beneficial owner.)

trust. He is not, therefore, an ultimate controller but rather acts *on behalf of* someone else and is under fiduciary obligations.
- The *settlor*, because he initiated the trust and contributed the asset to the trust in the first place. He, however, is no longer able to exercise control over the trust.
- The *beneficiary*, because he stands to benefit. But he similarly cannot exercise control over the trust.

The concept of beneficial ownership cannot be applied in a straightforward manner in these instances without knowing more about the context.

It is interesting to note that, when discussing the applicability of beneficial ownership obligations to trusts, compliance officers interviewed in connection with this study generally confirmed that all standard parties to the trust (settlor, trustee, and beneficiary) are relevant and should be considered. One can see why: If one person contributes an asset, another manages it, and yet another will benefit from it, who really is in control? In whom should a compliance officer be most interested? When a service provider is dealing with a prospective client, he does not know at that point (at the beginning of a relationship) what the relationship will involve in practice. All he or she has is some information provided by his or her client. In that case, the wisest course is to gather information on all parties who could be relevant.

Control in Foundations

The vehicle of the foundation could be subjected to a similar analysis as a trust: It also cannot be *owned* by someone else. Although control might appear less problematic in this case (the director or board of the foundation is the obvious first point to look at), in the context of a private foundation with a private beneficiary, such a first-round analysis would be too simplistic—the private beneficiary is also of interest.

The Relationship between Ownership and Control

The FATF definition also refers to "the natural person(s) who ultimately owns . . . a customer." Because natural persons cannot be owned, the "customer" mentioned as being "owned" can only refer to a corporate vehicle. But what does ultimate ownership of a corporate vehicle really mean? The definition stipulates that, in such cases, the beneficial owner includes all people who have "ultimate effective control." According to the FATF methodology, for companies, this normally would entail identifying the people who have a controlling interest and those who make up "the mind and management of a company."[11] So the definition moves from someone who *owns* a corporate entity to someone who holds a *controlling interest* in it. In other words, ownership is a proxy for control and, in this context, is only relevant to the extent that control can be inferred from it.

[11] See 5.5.2 (b) of the *Methodology for Assessing Compliance with the FATF 40 Recommendations and the FATF 9 Special Recommendations,* p. 16, available online at http://www.fatf-gafi.org/dataoecd/16/54/40339628.pdf.

When Ownership Does Not Automatically Imply Control: The Company Example

The most common type of owner of a corporate vehicle is the shareholder in a company. The assumption that control automatically can be inferred from ownership requires further analysis. In the United States context, Section 405 of the Exchange Act defines control as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise." The clear implication is that it is possible to exercise control in ways other than through owning "voting securities" (that is, shares).

We have mentioned the control that can be exercised by people in certain positions within the company (for example, board members, executives, and financial officers). Outsiders (that is, those without legal title) also can exercise control if they possess certain contractual rights. Creditors, for instance, can exercise control if they have been given the right to block or approve certain significant transactions of the company or to convert their debt into stock at the occurrence of a particular event. In addition, options and other convertible securities may vest a *potential* for control in certain individuals without vesting them with *actual* control.

The converse situation also arises. Just as it is possible to exercise control over a company without having any legal title to it, so too is it possible to have legal title but be unable to exercise ultimate control. For example, suppose only a minority of the directors is up for election in a particular year. A majority shareholder would then not be able to vote out the board of directors at one election. Or suppose the company in question has issued stocks that carry no voting rights but entail certain economic advantages (such as preferred shares).[12]

In other words, although shareholders with a sizable stake in a company normally may expect to have a certain amount of control over it, they may find that many other people, for totally legitimate reasons, have an overriding say in the company's affairs, such as to render those people, and not the shareholder, the true beneficial owner.

The Ultimate Solicitor: A Hidden Controller

In the FATF definition, the wording "person on whose behalf a transaction is conducted" is intended to ensure that a service provider finds out whether the natural person with whom he or she engages is acting of his or her own accord or is representing the interests of a third party, who consequently also needs to be identified. It could be argued that this concept is covered by the earlier wording "person who ultimately controls the customer." A different way of reading it, however, is of particular interest in the context of this study.

[12] For a comprehensive discussion of the ways in which control of a corporate entity is distinguished from ownership, see Rafael LaPorta, Florencio Lopez de Silanes, Andrei Shleifer, "Corporate Ownership Around the World," Harvard Institute of Economic Research, Paper No. 1840, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=103130. See also J. W. Verret, "Terrorism Finance, Business Associations and the Incorporation Transparency Act," George Mason University School of Law, *Louisiana Law Review* 70, no. 3 (Spring 2010), pp. 857–910.

In dealing with a multinational company, for example, a service provider may find it useful to know who ultimately owns or controls the company but is unlikely to pose much money laundering risk. After all, information about major shareholders and the board of management is in the public domain. Much more interesting from an anti-corruption, anti-money laundering point of view is the identity of the company employee who, *within* this big corporate structure, is ultimately controlling this particular business relationship. The transaction in question may be designed to facilitate payment of a bribe, to set up a slush fund, or (outside the realm of anticorruption) to defraud the company.

Who ultimately requested it? The answer to this question is not necessarily the beneficial owner of the company as a whole. It may well be someone of much lower rank within the management structure. We may call this person the "ultimate solicitor." In that sense, then, this part of the definition expands the original circle of persons to be identified.

Effective Control
The final element in the FATF definition refers to "those persons who exercise ultimate effective control over a legal person or arrangement." The focus is not on the obligation of service providers to identify the beneficial owner of a vehicle as such, but rather on those people who exercise ultimate *effective* control over a corporate vehicle—that is, the parties who, regardless of any service provision, control what happens to the assets.

2.4 Applying the Concept of Beneficial Ownership in Practice

Fortunately, in the majority of cases, identifying the beneficial owner is easier than the theoretical discussion would suggest. Normally, anyone incorporating a company to engage in business or forming a legal arrangement for legitimate purposes is going to ensure that how control is to be shared is predetermined and understood, and then that it is further delegated, in relation to specific functions, to employees or agents. Each of the relationships mentioned in the previous section often involve an individual or a small group of people, and a service provider consequently will not have too much difficulty in establishing the identity of the beneficial owner or owners. This report, however, focuses on the area of greatest risks—the small proportion of cases in which corporate vehicles are established for illegal purposes—and explores how, in such cases, outsiders may find information about what really is going on.

2.4.1 Two Approaches to Meet Different Needs

How can a service provider whose only dealings with a corporate vehicle are to open a bank account, or to provide some other financial service, obtain sufficient information to be able to say with any degree of certainty who the beneficial owner is? The provider may be able to obtain documents showing the corporate structure (such as the register of shareholders and constitutional documents), and he or she may be able to see management board decisions and inspect identification and trust-related documents. Such a service provider, however, generally will have access to less information than an investigator. Of necessity, the service provider will have to rely on representations by the client and cannot be expected to verify all the information presented. The provider can verify whether the information corresponds with the account activity of a corporate vehicle, but that is about the limit of what the provider can be expected to do.[13] A well-resourced and expert criminal can circumvent any due diligence program, no matter how sophisticated.[14]

To help service providers implement due diligence obligations and to ensure that institutions undertake due diligence of similar scope, many countries have adopted a "formal" approach to beneficial ownership, allowing for the inference of beneficial ownership in cases in which a person fulfills a predefined criterion. In contrast, the approach taken by investigators can be termed a "substantive" approach.

A Formal Approach to Beneficial Ownership

A formal definition of beneficial ownership is one that strictly delineates a set of sufficient conditions that qualify certain owners, controllers, and beneficiaries unequivocally as the beneficial owners of a corporate vehicle. This definition is formed on the basis of the assumption that, in the vast majority of situations, to be able to exercise ultimate effective control over a corporate vehicle, an individual will require a measure of legally acknowledgeable authority. Under this approach, the express focus is not the person who actually is exercising ultimate effective control of the corporate vehicle, but rather the person who normally would have legal authority to do so. The "sufficient condition" most frequently used to qualify someone as a beneficial owner is quantitative—for example, with companies, possession of a certain percentage of ownership or voting rights to a corporate vehicle.

Of the 40 countries surveyed for the purposes of this study, a significant number (14) were found to apply just such a quantitative understanding of beneficial ownership. This understanding took different forms. In some cases, it involved owning a standard minimum percentage of shares (varying from 10 to 25 percent), whereas in one country, an adaptive concept was applied, namely, "ownership amounting to voting rights significant enough to elect a majority of the directors," which (absent any peculiar bylaws indicating to the contrary) one typically would assume to be a much higher threshold (51 percent). In part because of its place in the European Union Third Anti-Money Laundering Directive, a quantitative threshold of 25 percent appears to be rapidly becoming the standard for many nations, both within and outside of Europe, that employ this formal approach.[15]

[13] Many financial institutions use databases supplied by companies such as World-Check and Factiva to check the background of the people they are dealing with, and in this way gain leads to a potential criminal. The point, however, is to show that *for service providers* the scope for far-reaching verification measures is limited.

[14] As was also recognized by some of the compliance officers interviewed for this study.

[15] Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005, article 3 (6). "Beneficial owner means the natural person(s) who ultimately owns or controls the customer and/or the

A Substantive Approach to Beneficial Ownership

With its focus on ultimate control, the FATF definition is a good example of a substantive approach. "Beneficial ownership" pierces through the parties, who (like the corporate vehicles) merely represent the mode by which the will of the final actor is being effected.[16]

This focus is echoed by the Wolfsberg Group of banks:

> The term "beneficial ownership" is conventionally used in anti-money laundering contexts to refer to that level of ownership in funds that, as a practical matter, equates with control over such funds or entitlement to such funds. "Control" or "entitlement" in this practical sense is to be distinguished from mere signature authority or mere legal title. The term reflects a recognition that a person in whose name an account is opened with a bank is not necessarily the person who ultimately controls such funds or who is ultimately entitled to such funds. This distinction is important because the focus of anti-money laundering guidelines—and this is fundamental to the guidelines—needs to be on the person who has this ultimate level of control or entitlement.[17]

Although oriented toward the beneficial ownership of bank accounts, which may be easier to deal with conceptually than that of corporate vehicles, this approach places the emphasis on determining who *actually* is guiding the relevant activity, rather than who theoretically possesses enough of a legal claim to be able to do so. The Wolfsberg Group of banks has aligned itself with the substantive approach to beneficial ownership on the grounds that this approach is more in line with the intention of disrupting money laundering, because it includes those persons who might effect their ultimate control of a corporate vehicle outside of the legal strictures of a more formal definition.

natural person on whose behalf a transaction or activity is being conducted. The beneficial owner shall at least include:

(a) in the case of corporate entities:
   (i) the natural person(s) who ultimately owns or controls a legal entity through direct or indirect ownership or control over a sufficient percentage of the shares or voting rights in that legal entity, including through bearer share holdings, other than a company listed on a regulated market that is subject to disclosure requirements consistent with Community legislation or subject to equivalent international standards; a percentage of 25% plus one share shall be deemed sufficient to meet this criterion;
   (ii) the natural person(s) who otherwise exercises control over the management of a legal entity;

(b) in the case of legal entities, such as foundations, and legal arrangements, such as trusts, which administer and distribute funds:
   (i) where the future beneficiaries have already been determined, the natural person(s) who is the beneficiary of 25% or more of the property of a legal arrangement or entity;
   (ii) where the individuals that benefit from the legal arrangement or entity have yet to be determined, the class of persons in whose main interest the legal arrangement or entity is set up or operates;
   (iii) the natural person(s) who exercises control over 25% or more of the property of a legal arrangement or entity."

[16] Such natural persons that this description alludes to include the class of nominees, trustees, agents, or any other "front men" who wield legal authority, which may extend to full legal control, authority, or ownership of a corporate vehicle (for example, a TCSP-provided nominee shareholder who legally owns 100 percent of the shares in a company, but only on behalf of the beneficial owner, as his trustee).

[17] See http://www.wolfsberg-principles.com/faq-ownership.html.

2.5 The Service Provider's Perspective

Consultations with service providers during this study confirm that they typically use the "shareholders owning the company" understanding of beneficial ownership, because it is the one that applies in most of the situations they are confronted with. This perspective is not surprising, given that the majority of any jurisdiction's corporate vehicles will be companies. Furthermore, such a focus on companies is justifiable when one looks at patterns of misuse. From the review of the 150 grand corruption cases undertaken for this study, three-quarters of all the corporate vehicles that were misused were private companies or corporations. This suggests that ownership is at least a useful criterion, even if it does not always lead to the identification of the person who is (or should be) the object of further investigation.

Banks

When conducting business with another financial institution (for example, transferring money or receiving introduced business), a bank may feel uncomfortable about relying on the other institution's customer due diligence. Although the institution in question may be in good standing and be considered by its jurisdictional authorities to have robust client identification and verification procedures, the institution and the bank may differ in the depth to which they believe they should drill down to establish the beneficial owner. In these circumstances, the bank is faced with three less-than-ideal options: (a) turning down the business, (b) compromising its own internal standards by accepting the other's due diligence at face value, or (c) undertaking its own customer due diligence at its own expense. The costs in terms of potential lost profit, increased exposure to risk, or additional expense are potentially high. These costs can be reduced, however, if the use of quantitative standards becomes widespread and financial institutions use comparable methods and criteria for determining customer due diligence (CDD), creating a level playing field.

This approach has two further benefits. First, it instills confidence in the institutions when asserting to clients that they need to comply with the disclosure demands made on them. And second, the more jurisdictions adhere to the same threshold standard, the less effective institution-shopping and jurisdiction-shopping strategies become—strategies that often are employed by corrupt clients seeking to circumvent beneficial ownership disclosure.

Not all banks are created equal, however. Certain banks engage predominantly in business that generally is considered to present minimal anti-money laundering and combating the financing of terrorism (AML/CFT) risk. Quantitative standards allow such institutions to show that their CDD efforts have been made to the requisite degree and in good faith, even if some residual risk may persist. The converse holds as well. When a bank believes it is at risk of becoming a party to money laundering, then it has to adopt a more substantive approach. The bank needs to go well beyond simply scrutinizing the formal positions in a corporate vehicle and must undertake a more thorough investigation of all of the particulars of a corporate vehicle before agreeing to undertake business on behalf of that vehicle.

For that reason, certain banks interviewed for this study questioned the value of using the percentage-threshold method. Although it may be a perfectly adequate way to identify the beneficial owner in the overwhelming majority of situations, in cases of abuse (they argued) it is unlikely to be helpful in identifying the real beneficial owner. Banks refer to a typology sometimes called the "foot in the door" approach: A corporate account is classified as low risk at the beginning of the relationship. Three months after the account is opened, a previously unknown party appears on the scene, as a beneficiary of certain transactions or as vested with signatory powers to the account. This person has no ostensible connection to the corporate vehicle: he occupies no formal position of control and does not possess any relevant shareholding. A focus on percentage shareholdings or formal control thus would fail to identify this person as being of interest. It is therefore imperative that financial institutions be aware of the shortcomings of such an approach and "dig deeper" when circumstances so dictate—as well as maintain effective ongoing monitoring of business relationships.

The Problem of "Close Associates"

Anxious to secure their ill-gotten wealth, many corrupt parties seek to maintain a measure of control over the corporate vehicles involved in their scheme. To do this, they often use means that, although they would not be revealed under the strictly formal approach, nonetheless are legally enforceable. Fortunately, this legal enforceability enables an investigator to construct a "path" of control, however circuitous and oblique, from the asset to the corrupt official. In other instances, however, that path of legally enforceable control may stop short of reaching the official. Instead, it may stop at one or more "close associates"—that is, individuals in the circle of relatives, friends, and trusted associates and professionals around the corrupt official who can, in some way, exert legal control on his or her behalf. The more powerful the official, the wider the circle may be.[18] And although identifying the primary corrupt official as beneficial owner may be a difficult enough task, determining whether a person belongs to this circle of close associates is even more problematic.[19]

This involvement of other parties in the chain of control is confirmed by our review of three decades of corruption cases (1980–2010). This review demonstrated that the structure of control has trended toward the removal of the primary actor from the legal framework of misused corporate vehicles and the more frequent use of close associates.

[18] Such a "path of legally enforceable control" cannot always be established. See, for example, the discussion on the use of shell companies, which notes that, in some cases, a criminal is able to use a certain corporate vehicle while having no legal ownership or control of it.

[19] For a wider discussion of this topic, see Theodore S. Greenberg, Larissa Gray, Delphine Schantz, Carolin Gardner, and Michael Latham, *Politically Exposed Persons: Preventive Measures for the Banking Sector* (Washington, DC: World Bank, 2010).

One investigator commented on his firsthand experiences with this phenomenon: "The Abacha case, in which the connection between the asset and the principal (that is, the beneficial owner) was relatively easily established, was a crime of the 1990s; corruption cases we see now tend to be significantly more complicated."

One way in which a corrupt official can exert control without revealing himself is by having signatory authority over the corporate vehicle's financial accounts. This authority can be justified to the bank by deceptively listing the corrupt party as a low-level financial employee (see box 2.2). Financial institutions have identified this typology and it features in the case studies (see appendix D). Another strategy is to vest the ownership and control of the corporate vehicle in the hands of a front man who (out of loyalty or fear or on account of a financial incentive) is prepared to do the corrupt party's bidding. As such cases show, under the formal approach, it is perfectly possible for a corrupt party to achieve control of a corporate vehicle, both from within and outside the vehicle's structure, without running the risk of being identified as the beneficial owner.

BOX 2.2 Basic Attempt at a Concealment

The Case of Sweet Pink Inc. and Unlimited Horizon Inc.[a]

From 2004 to 2008, Teodoro Nguema Obiang Mangue, the son of Teodoro Nguema Obiang Mbasogo, the president of Equatorial Guinea, used U.S. lawyers, bankers, real estate agents, and escrow agents to move over US$110 million in suspect funds into the United States. George Nagler was one of the lawyers who, from 2005 to 2007 helped him purchase and manage property in Malibu, California, and incorporated shell companies for him.

According to a U.S. Senate investigation report, Nagler began working for Obiang in September 2005, after being contacted through the Internet by Obiang's executive assistant, Rosalina Romo. Nagler told the Subcommittee that he was asked at that time to form a corporation to "employ individuals at the home the Client maintained before he purchased the Malibu property and to handle payroll and other matters related to the employment of those individuals." In an e-mail dated September 15, 2005, Nagler asked Romo to provide him with two or three names for the corporation. Later that same day, the requested articles of incorporation were filed with the California Secretary of State for "Sweet Pink Inc." The Statement of Information for Sweet Pink Inc. listed Romo as the company's chief executive officer, secretary, and chief financial officer. Obiang is listed as "assistant treasurer," but in a letter by his legal counsel to the Senate subcommittee, Nagler conveyed that it was his understanding that Obiang "was the sole owner" of the corporation and was the "sole source of funding for the corporation." A few days later, Nagler was told that Eve Jeffers, a hip-hop musician and Obiang's then-girlfriend, would become the president of the corporation.

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BOX 2.2 *(continued)*

On September 29, 2005, a checking account in the name of Sweet Pink Inc. was opened at Union Bank of California. Jeffers was a signatory, along with four other persons. Obiang was not on the signature card. During October 2005, two wire transfers, each for nearly US$30,000, were deposited into the account from one of Obiang's Equatorial Guinea companies. Union Bank told the Senate subcommittee that it first became aware of Obiang-related account activity in 2004, after the bank deemed Equatorial Guinea to be a high-risk country and conducted a search for Equatorial Guinea wire transfers. The search identified one large wire transfer in 2001of US$6.2 million and seven smaller wire transfers from 2003 to 2004. On October 27, 2005, less than one month after the Sweet Pink account had been opened, the bank closed it.

The Senate report also noted that over a 10-month period from 2006 to 2007, Equatorial Guinea wire transfers totaling more than US$1.7 million were deposited into the law office account of another attorney, Michael Berger, who was "instrumental in opening the shell company [Unlimited Horizon Inc.] and law office accounts, moving Obiang funds through them, and masking Obiang's financial activities from the bank."[b] The US$1.7 million in Equatorial Guinea wire transfers sent to the Berger law office account triggered internal bank AML (anti-money laundering) alerts, but the bank was in the midst of negotiating a deferred prosecution agreement with the U.S. Justice Department for order deficiencies in its AML program. In June 2007, the bank finally reviewed the transactions and concluded that the Equatorial Bank wire transfers were suspicious, raising both fraud and AML concerns and subsequently closed all three accounts.

Note: a. U.S. Senate Permanent Subcommittee on Investigations, Majority and Minority Staff Report, "Keeping Foreign Corruption Out of the United States: Four Case Histories," Released in Conjunction with the Permanent Subcommittee on Investigations February 4, 2010, Hearing, pp. 49–50, citing as the source an August 1, 2008, letter from Nagler's legal counsel to the subcommittee, PSI-Nagler-02-0002. Id. at fn. 215. According to the Senate report, Nagler provided documents in response to a subcommittee subpoena and answered written questions from the subcommittee. Id., p. 48. Union Bank of California information from same report at pp. 31–32.
b. Id., p. 31.

2.6 Conclusion and Recommendations

Beneficial ownership is a concept that is relatively straightforward in theory but difficult to apply in practice. The essence is to identify the person who ultimately controls a corporate vehicle. This identification always will be a highly context-dependent, de facto judgment; beneficial ownership cannot be reduced to a legal definition. Even when a service provider takes a substantive approach (that is, goes further than a purely formal approach would require), the provider can do only so much to determine control. With few exceptions, service providers do not have the resources or the access to information they need to really *investigate* a corporate vehicle. Certainly, they can ask questions, search databases for information, and compare whether a vehicle's financial conduct matches its profile. But they cannot do much more than that. In the end, any due diligence system can be beaten.

The difference between the substantive and formal approach is that the substantive approach remains open-minded about who the beneficial owner may be, and it takes the outcome of the formal approach as a working hypothesis rather than as a final, definitive conclusion. In addition, the substantive approach goes beyond making inquiries about office holders and shareholdings, important as these are. The approach requires all economic realities to be considered when determining beneficial ownership—when taking on a new customer and thereafter—constantly reviewing whether this information is coherent with everything else known (or thought to be known) about the customer.

That said, having information on the 25 percent shareholder still has merit. Even if the shareholder is not the beneficial owner, the shareholder certainly is going to be a person of interest in any due diligence and normally would constitute a further source of information.

The above conclusions lead us to make the following four recommendations:

Recommendation 1. Countries should ensure that, whatever definition of beneficial ownership they employ, the beneficial owner is *always* a natural person.

Without adherence to this basic principle, the concept of beneficial ownership is virtually useless. Every legal entity and arrangement is ultimately controlled by a natural person. A policy that does not require a service provider to penetrate to this level is deficient in terms of efficacy, deterrence and justice.

Recommendation 2. Countries should consider introducing an alternative term for those persons currently described under formal approaches as beneficial owners.

Formal approaches, such as those based on percentage thresholds of ownership of legal entities, are certainly able to provide actionable information on persons of interest to law enforcement in a corruption or money laundering investigation. A term that clarifies this distinction will facilitate communication on the topic.[a]

Recommendation 3. Countries should develop a clear formal standard for identifying standard parties likely to be the beneficial owner but should require deeper inquiry in high-risk scenarios.

To maintain the focus on the substantive, economic meaning of beneficial ownership, countries that have adopted a formal approach should make it clear in legislation and guidance that the pertinent threshold is a *minimum* standard. They should also make it clear that reporting institutions (financial institutions, trust and company service providers, and others) have a legal obligation when confronted with suspicious circumstances to undertake further inquiry to identify and record information on other parties who appear relevant.

Recommendation 4. Ongoing due diligence should be used to bridge the gap between the formal and substantive approaches toward collecting beneficial ownership information.

Service providers should be aware of the dangers of relying on evadable standards, confirmed only by client-provided information and public records. They should employ ongoing verification practices to determine whether the information clients provide is consistent with the services requested and the transactions taking place. In suspicious cases, they should dig deeper to find out whether other natural persons (beyond the formal, legally declared power holders) really are in control.

Note: a. The participants in this study used various terminology schemes to describe the distinction between the "formal" and "substantive" beneficial owners referred to here. These included "Nominal/Legal/Registered Owner v. Beneficial Owner," "Beneficial Owner v. Ultimate Beneficial Owner," "Persons of Interest v. Beneficial Owner," and "Beneficial Owner v. Ultimate Controller." None of these proposed dichotomies is without its problems, however: "nominal," "registered," and "legal" are not synonymous, and each has shades of meaning that invite criticism if chosen; the idea of a beneficial owner not being an ultimate beneficial owner seems to be splitting hairs; "persons of interest" is vague and possibly accusatory.