



ICSA

INTERNATIONAL COUNCIL of SECURITIES ASSOCIATIONS

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Mr. Pieter Smit
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Financial Intelligence Centre
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Re: Comments on proposed revisions to FATF Recommendations on beneficial ownership

Dear Messrs. Fernandez-Bollo and Smit:

On behalf of the members of the ICSA Working Group on AML, which participates in FATF's Consultative Forum as the representative of the securities industry, we would like to thank you for the opportunity to engage with the FATF Secretariat and FATF representatives during the meeting in Vienna on the 3rd May.¹ ICSA members appreciate and strongly support the open dialogue that FATF has established with private sector representatives in order to enhance AML regimes at both the international and domestic level, and note that the May 3rd meeting in Vienna was an important part of that dialogue.

We understand that FATF Members are considering a variety of changes to the FATF Recommendations, including possible changes to the Recommendations on beneficial ownership. In order to support the dialogue between the FATF and the private sector, as well as the FATF's potential revisions of its Recommendations, we have prepared this letter to summarize the ICSA Working Group's concerns regarding the FATF's current Recommendations on beneficial ownership. These concerns, which are discussed more in depth below, include the following:

¹ ICSA is composed of trade associations and self-regulatory organizations that collectively represent and/or regulate the vast majority of the world's securities firms on both a national and international basis (for more detail on membership, please visit: www.icsa.bz). ICSA's objectives are to encourage and promote: (1) the sound growth of the international securities markets by promoting harmonization and, where appropriate, mutual recognition in the procedures and regulation of those markets; and (2) mutual understanding and the exchange of information among ICSA members. ICSA's Working Group on AML, which is composed of representatives of ICSA members as well as market participants that work directly in the AML field, participates in FATF's Consultative Forum as the representative of the global securities industry.

- First, there is a need for additional guidance from the FATF to financial firms and member governments regarding what, how and when firms are to identify and separately verify the identity of beneficial owners and how individual governments should interpret and apply the FATF standards in their own jurisdictions.
- Second, there are critical problems concerning the availability of information that would allow securities firms and other financial institutions to appropriately identify and verify the identity of beneficial owners. In order to correct this problem, FATF needs to work with governments and other agencies in order to ensure that financial institutions charged with identifying and verifying the identity of beneficial owners have access to the necessary information to perform such functions.
- Third, there is a need to apply a risk based approach to the collection and verification of beneficial ownership information, which would allow financial institutions to allocate their AML/CFT resources to those situations that will be most effective in mitigating AML/CFT risks.

We are raising these matters since we believe that the FATF's Recommendations for beneficial ownership, as they are currently interpreted in various jurisdictions, are not as effective as they could be in the fight against money laundering and terrorist financing and, in fact, may be counterproductive since they result in the expenditure of finite AML/CFT resources that could be better utilized to address the AML/CFT issues that pose greater risks. For that reason, we strongly support revisions to the Recommendations that would make the beneficial owner due diligence regime, as part of the customer due diligence process, subject to a risk-based approach. That important change would allow financial firms to more efficiently utilize AML/CFT resources by allocating those resources to the customer relationships where attention is most warranted.

It is absolutely critical that FATF provide additional guidance on the implementation of its recommendations on beneficial owners and promote the enhanced availability of data so that financial firms can appropriately identify and verify identity of beneficial owners where warranted.

1. Need for additional guidance

One of the problems with the Recommendations on beneficial ownership is that they are interpreted differently in different jurisdictions. For example, a beneficial owner is defined in the FATF's glossary as, "*a natural person who owns or controls a customer and/or the person on whose behalf a transaction is being conducted.*" A beneficial owner is also defined as "*those persons who exercise ultimate effective control over a legal person or arrangement*". However, there exists differing interpretations across jurisdictions for the same situation as to which individuals effectively meet this definition. The ambiguity in the definition between control and ownership can lead to the identification and verification of different individuals depending on each jurisdiction's interpretation. For example:

- The concept of "control", interpreted broadly, could lead to the identification of all board members as beneficial owners, whereas, taken individually each of them does not have the power to influence the outcome of the company and its use as a vehicle of money laundering and terrorist financing. There is therefore a need for a better delineation of the concept of

“control” so that it only refers to the persons who have the power or authority to transform into or use the entity as a vehicle of money laundering and terrorist financing.

- In trusts the beneficial owner may be looked at as either the trustees since they have control, the ultimate beneficiary or the settler/contributor since they may have an ownership claim. This is an issue when the actual beneficiaries are not known, as is the case in many trusts. Trusts can also be revocable, meaning that the assets of the trust would revert to the settlor or contributor. In that case, the beneficiary may not be, in fact, the party of greatest interest. Therefore additional guidance is needed on whether the focus should be on control of the trust or the “owners” of the trust. An additional challenge securities firms and financial institutions face is access to the trust documents and verification of the beneficial ownership information that they obtain from the trust advisors.

Moreover, because different jurisdictions interpret the FATF’s Recommendations on beneficial ownership differently, financial institutions that operate on a cross-border basis find that they cannot apply consistently their AML/CFT group policies. Additional guidance from the FATF regarding the Recommendations on beneficial owners would help to ensure a more consistent interpretation of the Recommendations on a global basis. Enhanced guidance regarding the Recommendations would also help to improve countries’ compliance with Recommendation 5, which most countries are not able to comply with according to FATF’s metrics.²

Specifically, the FATF should develop guidance that would eliminate the ambiguity in the Recommendations between control and ownership noted above. The FATF should also develop guidance for financial institutions to rely on the representations of trustees, advisors and other parties in order to better meet the requirements of the Recommendation. This would include, for example, guidance regarding trusts and hedge funds.

In addition, as you are aware different jurisdictions have put in place different thresholds for identifying and verifying the identity of beneficial owners. In order to ensure greater consistency on a global basis, the FATF should formally establish in its Recommendations standard thresholds for ownership interests both for lower risk and higher risk relationships.³ The Recommendations should also provide for some specific exemptions, which each financial institution could make use of in accordance with its own risk-based approach.

Finally, it would also be useful to have an international agreement regarding the types of legal persons for which beneficial ownership requirements might not be applicable, subject to a firm’s risk-based approach. These exceptions could apply, for example, to publicly traded entities, government bodies, as well as regulated financial institutions, pension funds and investment managers.

² For example, according to a recent report from the World Bank’s Stolen Asset Recovery (StAR) Initiative, 93% of the jurisdictions evaluated by FATF since 2007 were either non-compliant or only partially compliant with FATF’s Recommendation 5 and 84% were either non-compliant or partially compliant with Recommendation 6. See Theodore Greenburg and Larissa Grey, *Politically Exposed Persons: Preventative Measures for the Banking System* (World Bank, Washington, DC, 2010), page 14.

³ This standard threshold would be for AML/CFT purposes only, and would be separate from thresholds that have been established by regulators for other purposes.

2. Need for verifiable data

There are critical problems concerning the availability of information that would allow securities firms and other financial institutions to appropriately identify and verify beneficial owners. This is one of the greatest difficulties that financial firms face when trying to comply with the FATF's Recommendations on beneficial ownership. There is generally little if any information available from corporate registries in most jurisdictions regarding the actual beneficial owners of companies. Moreover, the information that is contained in corporate registries may not be publicly available or easily accessible. For example, a company could be formed by a law firm or a company formation agent who list as officers or directors the names of individuals that are in fact employees of the firm forming the company.⁴ The only written records of ownership may be in the offices of the company's lawyers or formation agents, where they are subject to the restrictions of legal privilege.

The scarcity of information and failure to require disclosure in filing requirements make financial institutions dependent on the representations of clients or their legal representatives as to the ownership structure. The ownership structure may likewise be dynamic and thus the information captured represents information at a given point in time. Financial institutions have limited, if any, means to verify that those statements are true. This issue is heightened in jurisdictions where data privacy regulations restrict or severely limit the release of information necessary for the verification of statements made by clients or their legal representatives. Finally, there is no uniformity in requirements in different jurisdictions regarding the updating of corporate information that would allow financial institutions to identify changes in the directors or ownership of a firm.

Given the importance of this issue, we believe it is absolutely essential that the FATF work with governments and other agencies to ensure that financial institutions charged with identifying and verifying the identity of beneficial owners have access to the necessary, current and appropriate information that would allow them to perform those functions. The failure of governments to make that information available severely restricts the ability of financial institutions to take reasonable steps to identify and verify the identity of beneficial owners or understand the ownership/control structure of a legal person.

Specifically it would be extremely helpful if FATF could encourage the development of more robust and publicly available corporate registries with enhanced beneficial ownership information while also encouraging more rigorous enforcement of filing requirements⁵. We believe that any

4 This can be done for immediate use or registered companies with no real owners or assets can be kept on the shelf for later needs. In many countries ownership is not registered initially or in subsequent filings.

5 We are aware that this would require considerable effort on the part of governments and other entities. However, in some cases corporate registries already exist and would only require a relatively modest change in order for them to be useful for AML/CFT purposes. For example, companies in the UK, have to publicly file their annual financial statements at the UK corporate register, Companies House. In accordance with the Companies Act of 2006, companies are required to identify in the Notes to the Financial Statements their ultimate parent company or ultimate controller. This information is subject to review by independent auditors. Although the definition of "ultimate parent company" and "ultimate controller" for the purposes of the Companies Act of 2006 differs from the concept of ultimate beneficial owner in AML/CFT terms, it would be possible for the definition in the Companies Act to be harmonized with the FATF requirements. In that case, financial institutions seeking to verify the identity of the ultimate beneficial owner(s) of UK based firms would be able to rely on the firms' audited financial statements. This process could then also serve as a model for other jurisdictions.

privacy concerns raised by the availability of such information could be resolved by imposing controls limiting access to those firms with bona fide reasons to obtain the information, including for AML/CFT purposes⁶. If such registries cannot be developed, FATF should provide guidance on the extent to which financial institutions can rely on a customer's representatives or officers as to its ownership.

3. Support for a risk-based approach

We strongly support revisions to the Recommendations that would make the beneficial owner due diligence regime, as part of the customer due diligence process, subject to a risk-based approach. A risk-based approach would allow securities firms and other financial institutions to more efficiently allocate their AML/CFT resources where most warranted.

During the May 3rd meeting in Vienna representatives of the World Bank presented the results of an ongoing study that they are conducting regarding the effectiveness of the FATF's beneficial ownership requirements. The study showed that beneficial ownership requirements in jurisdictions where they have been put into effect have not led to enhanced enforcement actions, thereby raising questions about the usefulness to law enforcement of the FATF's beneficial ownership requirements. This evidence may lend support for a risk based approach towards the collection of beneficial ownership information with respect to the risk of the client, whether verification is warranted, and the timing of the collection of the information

A corollary issue that we wish to acknowledge is the timing of the collection of the information. It has been a de facto expectation that this information is collected at time of the commencement of the relationship. ICSA offers that, in keeping with a risk based approach, it may be more efficient in those relationships the financial institutions deem to be of lower risk in accordance with its own evaluation to collect beneficial ownership information when an event triggers the financial institution to place more scrutiny on the client.

We understand that revisions of the FATF Recommendations and/or efforts by FATF members to provide more reliable data for AML/CFT purposes could result in both legislative and regulatory changes in individual jurisdictions that could precipitate changes in processes. We encourage both the FATF and FATF member governments to undertake appropriate cost benefit analysis of the current recommendations as well as an analysis of revised guidance, that would include the encouragement of a risk based approach to the collection and verification of beneficial ownership information. This analysis should focus on the risks that the FATF is trying to address while allowing financial institutions to apply their limited AML/CFT resources to those situations that will be most effective in mitigating, detecting and reporting money laundering/terrorist financing concerns.

⁶ Regarding the specific case of hedge funds, IOSCO's Task Force on Unregulated Financial Entities has published a set of global standards for the regulation of hedge funds, which includes the recommendation that regulators should require all hedge funds active in their jurisdictions to be registered. It is possible that the information in the registries on hedge funds that will be set up by regulators in different jurisdictions could be used by financial firms for the identification of and verification of identity of the beneficial owners of hedge funds. However, that would only be possible if regulators allow financial firms access to the hedge fund registries for AML/CFT purposes.

In closing, we would like to once again express our appreciation of and support for the work being done by FATF Members and the FATF Secretariat to review and update the FATF's AML/CFT Recommendations. We appreciate FATF's willingness to take into account the views of the private sector and look forward to working further with FATF members as the review continues. Please do not hesitate to contact us regarding any of the comments in this letter.

Best regards,

A handwritten signature in black ink, appearing to read "Marilyn Skiles". The signature is written in a cursive, flowing style.

Marilyn Skiles
Secretary General
International Council of
Securities Associations (ICSA)

cc: Jonathan Carlson, Principal Administrator, FATF