

Transparency of beneficial ownership registers (3/17/19)

This article explores how far we can rely on the information placed in the registers of beneficial owners.

The 4th directive on preventing the financial system from being used for money laundering provides that each EU member state should create a central register of beneficial owners and ensure that entities registered in its territory obtain and hold adequate, accurate and current information about their beneficial ownership. Each member state must ensure that beneficial ownership information is stored on its central register.

On 19 April 2018, the European Parliament adopted the 5th directive, which came into force on 9 July 2018. Under this directive, the member states have 18 months to pass it into their national legislation (by 10 January 2020). The directive requires public access to data on the beneficial owners of entities.

The European Union decided that creating mandatory registers of beneficial owners in all EU countries is the most effective way of disclosing the truth about the beneficial owner. But if the purpose of registers is to build confidence, then collecting information without proper control of its accuracy would be meaningless, as it takes a special skill set to understand the complex share ownership structures and identify any suspicious activities. Difficulties arose immediately in terms of data verification. Latvia, for example, holds companies responsible for updating their beneficial ownership information, while other countries do not specify who is responsible for data verification. This raises many questions, as it turns out that this reform has failed to bring any certainty about the reliability of data held on the registers.

Criminals involved in money laundering, terrorists and persons subject to sanctions try to gain access to the financial system by hiding their identity. This problem particularly arose at the stage of registering an entity, when they used family members, frontmen, and entities with a complex ownership structure. The main purpose of creating those registers was to facilitate obtaining information about the beneficial owners of entities and other interested parties, as well as to increase the transparency of ownership.

In Latvia, this service is not free. After completing a special application form and paying a stamp duty, the data is entered on the register. But the main problem is that it is entered without verification, relying on the information provided by the company.

Also, when completing a form for the Latvian Enterprise Registry, there are several options, including the possibility of not naming the beneficial owner and noting that "It is impossible to provide information," while also stating that all statutory AML requirements are met.

In late February 2019, the Enterprise Registry posted an informative report on its website stating that if beneficial owners are not disclosed in accordance with statutory requirements, the company's activity will be suspended. Also, the Enterprise Registry said the lack of information on beneficial owners in the registers stored at the Enterprise Registry may serve as a basis for a more rigorous due diligence review of customers, such as banks, accountants or notaries, and may even serve as a basis for refusing to work with an interested customer.

Interestingly, the 5th directive provides that the beneficial owner and the interested party may, on a reasoned request, in exceptional circumstances determined in each particular case, require that access to the information contained in the register be available only to national authorities, financial institutions and notaries performing their duties if access by the general public may expose the beneficial owner to a disproportionate risk of fraud, kidnapping, blackmail, harassment, violence or intimidation, or if the beneficial owner is underage or incapable. On receipt of the request, the Enterprise Registry should immediately block access to the general public as a temporary and preventive measure.

Why do the beneficial owner registers fail to solve the problem of transparency?

Central registers of beneficial ownership do not cover each and every facility operating in the EU. For example, offshore trusts created by EU citizens will not be covered by the new rules, so the “protagonists” of the Panama documents will continue classified.

Also, when creating registers, a number of high-risk tools commonly used to disguise the identity of beneficial owners, such as nominal shareholders and bearer shares, are overlooked. So, even if a register contains data on beneficial owners, this does not mean you can fully rely on that information. A solution to this problem could be the requirement for providing documentary evidence of ownership or control over the company or a legal due diligence review for a complicated structure. Denmark, which also recently created a public register of beneficial ownership for companies, requires that beneficial owners file a scanned copy of their passport or other national ID card to limit the possibility of false registration.

Vera Jourova, European Commissioner for Justice, Consumers and Gender Equality, described the progress made by 20 countries as slow and unsatisfactory, which means that the process of introducing registers is at an early stage and the desired result is to be achieved by trial and error.