



**IDENTIFICATION OF ULTIMATE BENEFICIARY OWNERSHIP  
AND CONTROL OF A CROSS-BORDER INVESTOR**

*March 2007*

*This report is published under the responsibility of the OECD Secretariat. It was prepared by former Director of the OECD Directorate for Financial and Enterprise Affairs, William H. Witherell, acting as an external consultant to the Investment Division, in support of discussions at the OECD Roundtable on Freedom of Investment in March 2007. It does not necessarily reflect the views of the OECD or those of its member governments.*

## IDENTIFICATION OF ULTIMATE BENEFICIAL OWNERSHIP AND CONTROL OF A CROSS-BORDER DIRECT INVESTOR

The Investment Committee's Roundtable on *Freedom of Investment, National Security and "Strategic" Industries* on 6 December 2006 identified the determination of the nationality of the ownership and control of an investor as an increasingly complex issue. The present note, for consideration at the Committee's Roundtable on 30 March 2007, presents a review of arrangements which have been found to make the identification of ultimate beneficial ownership and control difficult. It reviews potential implications for investment authorities when they have responsibility for assessing possible threats to essential security interests. In the discussion that follows, the "identity" of beneficial ownership and control is taken to include the nationality of the ultimate owners/controllers of an investment.

This Note draws heavily upon the extensive work that has been done on the issue of determining beneficial ownership and control in combating financial and economic crimes, such as money laundering, bribery and corruption, financing of terrorist activities, and securities and tax fraud. In particular, the Financial Stability Forum Working Group on Offshore Financial Centers asked the OECD in May 2000 to explore the issue of developing mechanisms to prevent the misuse of corporate vehicles<sup>1</sup> by ensuring that authorities are able to obtain information on the beneficial ownership and control of corporate entities and to share that information with foreign authorities. This work resulted in the 2001 *Report on the Misuse of Corporate Vehicles for Illicit Purposes*.<sup>2</sup>

The Financial Action Task Force (FATF), tasked with combating money laundering and terrorist financing, built upon the above study and other work to produce an extensive 2006 report<sup>3</sup> that focuses on what it considers to be the most significant feature of the misuse of corporate vehicles, the hiding of the true beneficial owner. A third important reference source is the work of the International Association of Securities Commissions (IOSCO), which gives particular attention to financial vehicles such as collective investment schemes, including hedge funds, and to authorized security service providers.<sup>4</sup> Also relevant is the work of the Wolfsberg Group of major financial institutions.<sup>5</sup>

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1. The term "corporate vehicles" in this note has the meaning used in the OECD reports cited in the following footnote and thus includes corporations, trusts, partnerships with limited liability characteristics, etc.
  2. Published as *Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes*, OECD 2001. See also the follow-up report *Options for Obtaining Beneficial Ownership and Control Information: A Template*, OECD 2002.
  3. *The Misuse of Corporate Vehicles, Including Trust and Company Service Providers*, Financial Action Task Force, 13 October 2006. Available on [www.fatf-gafi.com](http://www.fatf-gafi.com).
  4. See, in particular, *Principles on Client Identification and Beneficial Ownership for the Securities Industry*, IOSCO, May 2004, *The Regulatory Environment for Hedge Funds: A Survey and Comparison*, Technical Committee of IOSCO, March 2006, and *Anti-Money Laundering Guidance for Collective Investment Schemes*, Technical Committee of IOSCO, October, 2005. All are available on [www.iosco.org](http://www.iosco.org)
  5. See [www.wolfsberg-principles.com](http://www.wolfsberg-principles.com), in particular Wolfsberg Statement – Anti-Money Laundering Guidance for Mutual Funds and Other Pooled Investment Vehicles.

## **I. Corporate vehicles that can make it difficult to identify beneficial owners of cross-border investments**

Corporate entities, including corporations, trusts, foundations and partnerships with limited liability characteristics, are the basis for most entrepreneurial activities in market economies. Similarly, investment vehicles such as collective investment schemes, hedge funds, private equity funds, are increasingly important participants in the capital markets. These entities play legitimate roles. But they also can present significant challenges to national authorities seeking to determine the ownership and control of an investor. Under certain conditions, these entities may be used for illicit purposes as they share the common characteristic, to varying degrees, of enabling the perpetrators to conceal their identities.

The vulnerability of such entities for misuse is highest in jurisdictions that excessively constrain the capacity of authorities to obtain and share information on beneficial ownership and control for regulatory/supervisory and law enforcements purposes or/and allow corporate vehicles incorporated or established in their jurisdictions to employ instruments to obscure beneficial ownership and control such as bearer shares, nominee shareholders and nominee directors, without devising effective mechanisms that would enable authorities to determine the true owners and controllers. This section examines the corporate vehicles and other arrangements that have been found in the OECD, FATF and IOSCO studies cited above to raise the greatest difficulties with respect to ownership identification.

### **a) Corporations**

A corporation is a legal entity whose owners consist of shareholders. Corporations maintain a separate legal personality from their shareholders, a feature which provides the potential for anonymity. Shareholders are liable only up to the amount of their investments. Control of a corporation is vested in the board of directors. There are three types of corporation that have been found to be the most vulnerable to misuse.

- 1) **Private limited companies** are restricted in the number of shareholders and in the transferability of their shares, may not issue shares to the general public, nor are they able to trade their share on a stock exchange. In turn, private limited companies are not as closely regulated and supervised as public limited companies.
- 2) **Limited liability companies** have a hybrid business structure that provides the limited liability features of a corporation and the tax and operational flexibilities and the efficiencies of a partnership. They have fewer disclosure requirements, no annual reporting requirements and do not have a formal structure. They can be managed anonymously as there is no public disclosure of the members' identities.
- 3) **International business corporations and exempt companies** are limited liability entities incorporated in offshore financial centers (OFC) usually by non-residents. Often they have "anonymity" features. In many OFCs they can issue bearer shares and may employ nominee shareholders and nominee directors to disguise ownership and control. They often are subjected to little or no supervision, with no annual reporting requirements nor do they have to disclose beneficial ownership. A few jurisdictions, in contrast, prohibit the use of bearer shares, or if bearer shares are permitted, require the disclosure of beneficial ownership and control information.

### **b) Trusts**

Trusts are corporate vehicles that separate legal ownership (control) from beneficial ownership. They are used primarily in common law jurisdictions for the transfer and management of assets. To establish a

trust, the trust creator (the “settlor”) transfers the legal ownership of a property to a person or corporate entity (the “trustee”). The trustee holds and manages the property, in accordance with the provisions of a trust deed, for the benefit of the beneficiaries, who are identified in, or ascertainable from the trust deed. Trusts are not required to register in many jurisdictions and because of this it can be difficult to identify the beneficial owners who can hide behind the “cover” provided by the legal owner.

Trusts enjoy a greater degree of privacy and autonomy than other corporate vehicles. As a trust is a contractual agreement between two private persons the “settlor” and the “trustee”, virtually all jurisdictions recognising have chosen not to regulate trusts like other corporate vehicles. In most jurisdictions, no disclosure of the identity of the beneficiary or the settler is made to authorities. There are no registration requirements or central registries. In some jurisdictions, changes in trust laws now allow the names of the settlor and the beneficiaries to be left out of the trust deed.

**c) Foundations**

Foundations are the nearest civil law equivalent to a common law trust in that they may be used for similar purposes. A foundation is a separate legal entity controlled by a board of directors and has no owners or shareholders. As a legal entity a foundation may engage in and conduct business. Ordinarily, foundations are highly transparent and highly regulated vehicles. But in some civil law OFCs, foundations are not supervised, few public disclosures are required, founders are allowed to exercise control of the foundation, and a high degree of anonymity is offered.

**II. Mechanisms for achieving anonymity**

A variety of mechanisms can be used to enhance the anonymity inherent in the above corporate vehicles. While they have legitimate purposes, they also may be used to conceal beneficial owners.

**a) Bearer shares**

Bearer shares are negotiable instruments that accord ownership of a corporation to the person who has physical possession of the bearer share certificate. Bearer shares do not contain the name of the shareholder and are not registered, with the possible exception of their serial numbers. Companies issuing bearer shares are usually exempt from having to maintain a share register with respect to those shares. Bearer shares thus have a very high level of anonymity and can effectively obscure the ownership of a corporate vehicle, especially in certain jurisdictions and in certain commercial contexts, such as shell companies (companies that have no significant assets or operations) and international business corporations.

**b) Nominee shareholders**

A nominee is a person or corporation who has been appointed or designated to act for another. Nominee shareholders are permitted in most jurisdictions. With respect to publicly traded shares, registering shares in the names of stockbrokers is used to facilitate the clearance and settlement of trades. The use of nominees, however, reduces the usefulness of shareholder registers or lists, where these are required, because the shareholder of record may not be the ultimate beneficial owner.

**c) Nominee Directors and “corporate” directors**

Nominee Directors appear as a director on all company documents and in official registries, if required, but pass on all duties of a director to the beneficial owner. This compromises the function of a director as a means to impose responsibility on physical persons for the actions of a corporation. Nominee directors thus

can be used to conceal the ultimate beneficial owner and controller of a corporation. Many jurisdictions, including most OECD jurisdictions, do not recognise nominee directors.

The use of corporations as directors is permitted in many jurisdictions. Creating an extra layer in establishing the identity of the person who controls, corporate directors may be used as a device to obscure beneficial ownership and control unless the legal system can timely and effectively assign director responsibility to physical persons.

**d) *Flee clauses***

In some jurisdictions the trust law permits the trust deed to include a flee clause, which requires the trustee to change the governing law of the trust, move the trusts assets and documents to another jurisdiction and appoint a new trustee in a different jurisdiction upon the receipt of service of process or inquiry for information by the authorities. Such clauses make it more difficult for authorities to uncover the identity of the beneficial owner or the settler of the trust.

**e) *Chains of corporate vehicles and multi-jurisdictional structures***

In many cases a structure consisting of a series of corporate entities and trusts, often created in different jurisdictions (particularly those where beneficial ownership information is not maintained, readily available, or able to be shared), have been used to make it almost impossible to see behind the complex structure and identify the ultimate beneficiary. To give an example, consider a cross-border investment by an international business corporation (IBC) established in jurisdiction A, which is owned by an IBC in another jurisdiction B, which in turn is owned by an IBC in a third jurisdiction C which then is owned by a trust established in a fourth jurisdiction D in which there is no registration requirement. If the investment policy authorities are able to identify (likely with some difficulty) the IBC that is the beneficial owner of the trust, they will still face a daunting task of drilling through to the ultimate beneficial owner and controller of the IBC in jurisdiction A seeking to make the investment.

**f) *Intermediaries – Trust and company service providers (TCSPs) and collective investment schemes, including hedge funds***

Intermediaries such as company and trust formation agents, lawyers, trustees, various types of financial institutions play an important role in the formation and management of corporate vehicles. In OFCs in particular they often have played a key role in obscuring ultimate beneficial ownership. Such corporate service providers may design structures to ensure that the beneficial owner remains anonymous and often act as the intermediary between the client and the authorities in the jurisdiction of incorporation. They may provide nominee shareholders and nominee directors.

Private banks that cater to high net worth individuals have been known to establish shell companies to help their clients conceal their identities. Trustees, in certain jurisdictions where a trust holds shares in a company, the trustee appears as the record holder and does not have to disclose that he is holding the shares as a trustee. This may lead authorities to believe the trustee is the ultimate beneficiary owner.

There are many different forms of collective investment schemes (CIS) around the world. Exchange listed CIS publicly offer their shares to the investing public through trading on a securities exchange and are subject to the regulation of that exchange. The other, and predominant, form of CIS is the open-end CIS which publicly offer and redeem their shares or units to investors without the shares or units being listed and traded on a securities exchange. Exchange listed CIS do not open accounts for investors, while open-end CIS often do.

The legal structure of CIS vary considerably around the world – a company with a board of directors with management delegated to a separate entity, a limited partnership with the general partner responsible for management, or a trust or other contractual arrangement, with a trustee or custodian/depository with overall responsibility for management, except to the extent that the trust instrument assigns management responsibility to another entity.

In certain jurisdictions the prevalent business model has management functions not at the CIS level itself but higher up. In the United Kingdom open-end CIS are required to be operated by authorised fund managers (AFMs) that are specifically authorised and regulated for that purpose. Despite these differences, CIS generally are organised by financial intermediaries that often place their employees in formal management positions within the CIS. These financial intermediaries typically are retained to provide investment advice and to conduct the day-to-day operations.

Hedge funds are a subcategory of CIS for which there is no comprehensive legal definition. They are commonly recognised as an “alternative” investment product because of the management style employed and the types of risks adopted with the investment strategy. The IOSCO report cited in footnote 4 suggests that hedge funds have at least some of the following characteristics:

- Few or no borrowing or leverage restrictions;
- Significant performance fees in addition to an annual management fee;
- Investors permitted to redeem their interests periodically;
- Often significant “own” funds invested by the manager;
- Derivatives and short selling are used;
- Diverse risk and complex underlying products are involved.

General regulatory approaches to hedge funds vary from jurisdiction and within jurisdictions the approach may vary according to the extent of retail participation and investment strategies. Some jurisdictions subject hedge funds to limited regulatory oversight but do not register or authorise the funds. And there are some jurisdictions that have privately offered hedge funds that are not subject to registration or regulation. In the case of the UK and some other jurisdictions, hedge fund managers/advisers are authorised and regulated.

The referenced IOSCO papers focus on issues of investor (both natural persons and non-natural persons) identification and beneficial ownership of shares or units in a CIS. The difficulties in identification that may be encountered are similar to those already discussed above and relate to the level and quality of regulation, the use of corporate vehicles and anonymity-enhancing mechanisms and complex layers of institutions, and the willingness of jurisdictions to share information on beneficial ownership.

### **III. Options authorities may use to overcome obstacles to the identification of beneficial ownership and control**

Legal, supervisory and regulatory authorities have developed a number of methods for obtaining and sharing, on a timely basis, information on the beneficial ownership and control of corporate vehicles established in their jurisdictions. Not all options are suitable for all jurisdictions. Nor are they all suitable for use by investment policy officials, would they have authority in their country to investigate the identity of the ultimate beneficiary owner or controller of a particular investment.

Depending on their particular circumstances, some jurisdictions require extensive disclosure of beneficial ownership and control information up front at the formation stage and some impose an obligation to update such information when changes occur. Other jurisdictions, the majority, find they are able to rely on their compulsive power, court-ordered subpoenas and other legal measures to penetrate the legal entity in order to identify the beneficial owners when necessary. A growing number are supplementing these two approaches by requiring intermediaries involved in the formation and management of corporate vehicles to obtain, verify and retain records on beneficial ownership and control and to grant authorities access to such records for the purpose of investigating illicit activities, fulfilling their regulatory/supervisory functions (these could include the functions of investment policy authorities), or sharing with other domestic and foreign authorities.

The choice of mechanism for obtaining beneficial ownership and control information will depend on such factors as the nature of business activity in a jurisdiction, the extent and scope of non-resident ownership, the corporate regulatory regime, the powers and capacity of the regulatory and law enforcement authorities to obtain beneficial ownership and control information, the functioning of the judicial system. The earlier cited OECD report, *Options for Obtaining Beneficial Ownership and Control Information: a Template* is meant to be a resource to assist countries in assessing their current systems for obtaining information on beneficial ownership and control. The approaches adopted by countries will vary depending on local conditions, legal systems and practices; but three common fundamental objectives are stated:

- 1) Beneficial ownership and control information must be obtained or must be obtainable by the authorities;
- 2) There must be proper oversight and high integrity of any system established for the purpose;
- 3) Non-public information on beneficial ownership and control must be able to be shared with other regulators/supervisors and law enforcement authorities, both domestically and internationally.

Primary reliance on an up front disclosure system is most appropriate in jurisdictions with a generally weak investigative system, a high proportion of non-resident ownership of corporate vehicles, a high proportion of shell companies or asset holding companies and anonymity-enhancing instruments. This approach has the advantage that it insures that certain authorities will, at all times possess beneficial ownership and control information of corporate vehicles established in that jurisdiction. However, in jurisdictions with a substantial domestic commercial sector, an extensive up front disclosure system may impose significant costs on corporate vehicles (particularly smaller enterprises).

Primary reliance on an investigative system has been felt appropriate in jurisdictions where the authorities possess strong compulsory powers and capacity to obtain beneficial ownership and control information, there is a reliable history of enforcement, the judicial system functions effectively and efficiently, and the beneficial ownership and control information is likely to be available within the jurisdiction. For jurisdictions meeting these conditions, this approach may be the most cost effective for

the authorities and avoid unnecessary costs to the commercial sector. But this approach requires authorities to obtain information from third parties, thereby introducing the potentials for delays, particularly when these parties are in other jurisdictions.

The use of the intermediary option of imposing an obligation on corporate service providers to maintain beneficial ownership information requires adequate investigative mechanisms to effectively monitor compliance by corporate service providers, and a sufficient number of corporate service providers with suitable experience and adequate resources. This may be a lower cost option, as compared to a full fledged up front notification system, for jurisdictions with limited financial and trained human resources. It has been considered particularly appropriate for jurisdictions where persons connected to the corporate vehicle are not located within the jurisdiction and where the corporate service provider serves as the primary link to such vehicles. But this approach also requires the authorities to obtain the information from third parties and there may be delays.

#### **IV. Sources of information**

Investment policy officials can obtain information about beneficial ownership and control of corporate vehicles that have undertaken or propose to undertake investments in their jurisdiction from a variety of sources:

- 1) *Corporate vehicles – shareholder registries.* Corporate vehicles are often required to maintain shareholder registers. These lists are then available to competent shareholders. While shareholder registers may contain accurate information on legal ownership but not necessarily on beneficial ownership.
- 2) *Company registries.* Most jurisdictions have company registries with information on legal ownership – and not necessarily the beneficial ownership of the corporate vehicle. The extent of the information available varies significantly from jurisdiction to jurisdiction. Some require full shareholder information, others only partial information. Many include foundations and limited liability partnerships in these registries, but just a few include trusts. Some provide information just from the time of creation and have no update obligation. For other jurisdictions, regular updating of the registry, including changes in shareholding, is mandatory, but very few require that any change in beneficial ownership of shares be reported to the registry. In almost all cases these registries are accessible to the public. Despite their various limitations checking company registries is considered to be an important first step in obtaining information about the structure of the corporate vehicles participating in an investment.
- 3) *Intermediaries such as TCSPs, lawyers, notaries and accountants.* As mentioned earlier, intermediaries commonly play a role in the formation and management of corporate vehicles. In a number of jurisdictions TCSPs are required to carry out due diligence procedures based on a verified identification of the beneficial owner. In jurisdictions where TCSPs are used for the formation and management of corporate vehicles, the TCSPs face sanctions for deficiencies in exercising due diligence. In a limited number of jurisdictions financial institutions are relied upon to obtain information on beneficial ownership.
- 4) *Other domestic sources.* A jurisdiction's investigatory powers can be used to gather information on beneficial ownership from public records as well as the authority to compel corporate vehicles to release information. These powers can be used to examine tax returns, retrieve information from online data bases, and from a jurisdictions securities exchange commission.



- 5) *Sharing beneficial ownership and control information internationally.* Difficulties in obtaining beneficial ownership information from the above sources are compounded when there are one or more cross-border relationships in the case under review, including foreign bank accounts. Situations involving corporate vehicles stacked on top of each other in a complex multi-jurisdictional structure that appears to lack economic and/or logistic justification should raise a significant warning to investment policy officials that the ultimate beneficial owner(s) of the investment are seeking to hide their true identity. In order to address such situations successfully, it is essential that authorities in each jurisdiction have the capacity to share information on beneficial ownership and control of corporate vehicles with other authorities domestically and internationally, respecting each jurisdiction's on fundamental legal principles.

A great deal of work has been done to enhance international cooperation among regulators, supervisors and law enforcement authorities to combat financial crimes and regulatory abuse. Of particular relevance to sharing information on beneficial ownership and control of corporate vehicles are the 1998 *G-7 Ten Key Principles on Information Sharing* and the 1999 *G-7 Ten Key Principles for the Improvement of International Cooperation Regarding Financial Crime and Regulatory Abuse*.<sup>6</sup> Investment policy officials are not considered to be "law enforcement authorities", nor are they in most cases considered to be financial supervisors or regulators. Nevertheless these principles should be applicable also to situations where the investment policy authorities are seeking information on beneficial ownership and/or control pursuant to their responsibilities with regard to protecting national security and essential national interests.

#### **V. Suggested lessons for the determination of the identity, including nationality, of beneficial owners and controllers of investments and the assessment of possible security risks**

Investment policy authorities that have been given jurisdiction to review transactions in relation to protection of essential security interests and to assess the potential threats posed by a particular investment transaction need to identify the ultimate ownership and control, including nationality, of the corporate vehicle that is being used to undertake the transaction. The preceding sections of this Note, drawn from the extensive experience of efforts to combat money laundering, terrorist finance, securities fraud and other financial crimes, indicates the difficulties that may face investment policy authorities in locating where relevant corporate vehicle information is held and how it can be obtained.

As the FATF have concluded, "...there appear to be two essential factors that further protect against the misuse of corporate vehicles: (1) the quality of available information and (2) the quality of the "gateway" through which that information can be obtained. There is little value in having good gateways if no information on beneficial ownership can be obtained. Likewise there is little value knowing that there is good quality information available when investigators are unable to get it."<sup>7</sup>

To assist authorities in assessing the potential threats posed by a particular transaction, the Financial Action Task Force<sup>8</sup> and the IOSCO's Principles for Client Identification and Beneficial Ownership for the Securities Industry<sup>9</sup> have established lists of risk assessment factors. In risk assessment factor lists, not all questions are applicable to every transaction; only in cases where the answers to significant questions are unsatisfactory, this should be considered a "red flag" to investigators, indicators that the ultimate beneficial owners/controllers are seeking to hide their identity, a factor which heightens the risk that the corporate vehicle will be "misused".

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6. See Annex II of *Behind the Corporate Veil*, OECD 2001.

7. FATF, op cit, p. 20.

8. FATF, op cit, pp 18-20.

9. IOSCO, May 2004, op cit.

Once the ultimate beneficial owners/controllers of an investment transaction have been sufficiently identified, including nationality, along with the other essential characteristics of the investment, it will remain for the relevant authorities to reach a judgement as to whether the transaction presents a risk to national security or other essential interests, and on remedies. The purpose of this note is not to suggest any general conclusions in this regard. In the areas of financial supervision and anti-money laundering enforcement, many countries maintain restrictions on or special attention to commercial transactions with certain countries of concern. Some jurisdictions have imposed sanctions prohibiting financial institutions from maintaining accounts for or on behalf of certain foreign financial institutions. Official lists of known terrorists, terrorist organizations and their sources of support would be another important reference.

## **VI. Concluding remarks**

Governments have the right, indeed, the obligation to protect the essential security of their populations; and at the same time, they recognise the benefits to all that come from maintaining open investment regimes and avoiding unnecessarily restrictive measures. An important factor in avoiding indiscriminate outright restrictions is the ability to identify the ultimate owner/controller of an international investment transaction, including their nationality. This information is essential if the investment authorities are to determine the real objectives and motivations underlying the transaction. It must also be recognised that obtaining names of beneficial owners and their passports may not, in some cases, be sufficient to determine what persons or possibly what state is controlling the enterprise. Further investigation may be needed.

The task of identifying ultimate ownership and control of cross-border transactions has become more challenging with the emergence of a large variety of international corporate and investment vehicles, some of which are designed specifically to obscure the identity of the beneficial owners and controllers. This Note has drawn upon the extensive experience of law enforcement, supervisory and regulatory authorities who have had to address this problem in their efforts to combat cross-border economic crime and abuse. This experience should provide considerable useful information for investment authorities when they are confronted with similar challenges.

International cooperation between national authorities has been found to be an essential factor in most cases of successful efforts to overcome obstacles to beneficial ownership. To date this cooperation has typically involved criminal investigations or regulatory/supervisory cooperation between national regulators/supervisors having similar mandates (e.g. securities commissions). One issue to consider is how national investment authorities responsible for implementing national security safeguards may best be able to obtain the international cooperation they may need to obtain essential ownership and control information that is available only in another jurisdiction.