Anti money laundering - Look through, behind and beyond: Seek and find the beneficial owner - a Luxembourg perspective

Publication - 12/05/2015

Introduction

Several mechanisms and arrangements are available for someone who wants to conceal his involvement in a transaction. The interposition of a legal entity (e.g. company or trust) between a professional and the ultimate beneficial owner of said transaction is not illegal per se. However, it makes it more difficult for professionals to prevent them from being used by criminals as intermediaries for the transfer or deposit of money derived from criminal activity. [i]

Pursuant to article 3(1) of the law of 12 November 2004 on the fight against money laundering and terrorist financing, as amended (the 2004 Law) [ii], professionals falling within the scope of the 2004 Law [iii] (in this briefing, the professionals) must apply due diligence measures when, amongst others:

- establishing a business relationship
- carrying out occasional transactions amounting to EUR 15,000 or more, whether the transaction is carried out in a single operation or in several operations which appear to be linked
- there is a suspicion of money laundering or terrorist financing, regardless of any derogation, exemption or threshold

In this respect, they are in particular required to:

- identify their customers and verify their identity
- identify, where applicable, the beneficial owner of such customers and take risk-based reasonable measures to verify their identity
- obtain information on the purpose and intended nature of the business relationship [iv]

Besides the obligation for professionals to know their customer, they are also required to identify who exactly can be considered as beneficial owner and to understand the sources and uses of funds, as well as the relationship between the nominal customer and the beneficial owner. Identifying a beneficial owner can be challenging though. In this briefing, we will define in a first stage the notion of "beneficial owner" [v]. We will then focus on certain guidelines used to identify the beneficial owner of corporate entities and other legal and contractual arrangements [vi]. Finally, we will briefly address the question of the rights and obligations of the beneficial owners [vii].

Determining the beneficial owner

Legal definition

The Directive 2005/60/EC (the Third Directive) emphasised the necessity to introduce a precise definition of “beneficial owner” [vii]. Drawing on the definition set out by the Financial Action Task Force (FATF) in its Forty Recommendations [viii], the Third Directive defines a beneficial owner as:

"[...], any natural person who ultimately owns or controls the customer and/or any 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) any natural person 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 more than 25% shall be deemed sufficient to meet this criterion;
(ii) any natural person 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, any natural person who is the beneficiary of 25% or more of the property of the 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) any natural person who exercises control over 25% or more of the property of a legal arrangement or entity."

This definition has been transposed verbatim in Luxembourg (article 1(7) of the 2004 Law) [ix].

The natural person behind the customer

Uncovering the beneficial owner involves piercing through the veil of various intermediary entities and/or individuals until the true owner is found [x]:

- when the customer is a legal person, the beneficial owner is the natural person who owns or controls such customer;
- when the customer is a natural person - since nobody can control or own a natural person - the beneficial owner will be the customer himself or the natural person who benefits from the operation. In this respect, the professional will have to determine whether the customer is acting on his own behalf or on behalf of another person [xi].

Beneficial owner under the OECD Model Tax Convention

The notion of “beneficial owner” under the 2004 Law should not be confused with the one used in the OECD Model Tax Convention.

In tax matters, the concept must be understood in light of the objectives of the OECD Model Tax Convention which are the avoidance of any double taxation and fiscal evasion. In this respect, the beneficial owner is the person or entity who economically has the benefit of an item of income. This concept is not necessarily like that of the AML legislation, where the one at the end of the chain who owns or controls the customer is understood to be the beneficial owner [xii].

The OECD approach demonstrates a significant subjective element (a benefit), while the determination of the beneficial owner in the AML legislation is based on objective elements [xiii].

Scope and strength of the requirement of identification

Scope

Article 5(2) of the 2004 Law requires professionals to identify both their customers and their respective beneficial owners. Once these persons are identified, their identity must be verified.

The customer's identity must be verified on the basis of documents, data or information obtained from a reliable and independent source. This requirement does not apply to the beneficial owners for which professionals are only requested to take reasonable measures to verify their identity and understand the ownership and control structure of the customer. Whether such measures are reasonable or not will depend on the risk category assigned to the customer on basis of specific attributes or behaviours.

Risk-based approach

The 2004 Law allows professionals to adopt a risk-based approach to determine the appropriate customer due diligence measures. The purpose of the risk-based approach is to focus efforts where they are needed [xiv].

On the one hand, the due diligence level is simplified for low risk clients (e.g. credit or financial institutions subject to equivalent anti-money laundering regulations and supervised, public authorities, listed companies) [xv]. On the other hand, enhanced customer due diligence measures are required in situations which by nature present a higher risk of money laundering or terrorist financing (e.g. non face-to-face business, foreign politically exposed persons and cross-border correspondent banking relationships with correspondent institutions from non-EU countries) [xvi].

No total exemption

The risk-based approach does not mean that, when the risk of money laundering and terrorist financing is low, a professional is exempted from the requirement to identify its customer and the beneficial owner.

The identification of such persons is a minimum requirement that must be satisfied, regardless of the level of risk associated with the customer. It is an obligation de résultat (an obligation to achieve a specific result). However, when deciding which reasonable steps must be taken to satisfy themselves that the customer and the beneficial owner's identities and information provided are correct, professionals may vary their approach depending on the risk assessment of the customer.

Scope and strength of the requirement of identification
Professionals may decide, based on their risk assessment, the cases when it is appropriate to rely solely on information provided by their customers and the cases where they need to obtain further or verify information from another source.

In order to determine the level of risk of money laundering and terrorist financing, a professional must be able to evidence that it has identified its customer and, where applicable, has also identified the customer’s beneficial owner. However, the measures to be taken to verify their identity will depend on the said determined risk level. For instance, if the risk of money-laundering and terrorist financing is high, the professional would be well advised to verify the identity of the beneficial owner on the basis of documents, data or information obtained from a reliable and independent source and not only on basis of documents produced by the customer [xvi].

Finding the beneficial owner

The person on whose behalf the transaction or activity is conducted

Declared representation – the proxyholder.

The proxyholder acts in the name and on behalf of his principal. Unlike a nominee (see below), the quality and powers of the proxyholder are disclosed to the professional. When he is a natural person, the principal (i.e. the person on whose behalf the transaction is conducted) will be considered as both the customer and the beneficial owner and must be identified by the professional. In addition, the professional is required to identify and verify the identity of the proxyholder as well as the degree of control that said person is authorised to exercise on behalf of the customer.

Undisclosed representation – the nominee

Luxembourg does not expressly prohibit nominee participation in legal entities. Nominees are even recognised actors of the distribution process of securities issued by a UCIs [xiv].

Professionals are required to ascertain whether their customers act for their own account or, where appropriate, for the account of other persons. If it appears from the information collected during the client take-on process that the customer acts as a “front man” to another person (i.e. in his own name but on behalf of another natural person), this person will have to be identified.

Professionals must therefore rely on the information provided by the customer himself as no other supporting information source exists. In order to prevent misuse of nominee shares and nominee directors, the FATF thus recommends countries to apply “[…] one or more of the following mechanisms: (a) requiring nominees shareholders and directors to disclose the identity of their nominator to the company and to any relevant registry, and for this information to be included in the relevant register; or (b) requiring nominees shareholders and directors to be licensed, for their nominees status to be recorded in company registries, and for them to maintain information identifying their nominator, and make this information available to the competent authorities upon request” [xx].

Professional intermediation

When an account is opened by a professional intermediary on behalf of a single client, this client must be identified by applying the client due diligence norms.

When the funds credited to the account are held on deposit or in escrow by the intermediary for a range of clients, one should distinguish whether such funds are co-mingled or not at the bank:

- if the funds are co-mingled, “sub-accounts” have been opened and can be attributed to each beneficial owner, the bank will have to look beyond the intermediary and identify each beneficiary (unless the intermediary is subject to the same regulatory and money laundering legislation and procedures as the bank)
- if the funds are co-mingled at the bank, the only way for the bank to identify the beneficiaries of the funds will be to rely on the customer due diligence done by the intermediary [xvi].

If the bank is not able to establish that the intermediary has engaged in a sound due diligence process and has the systems and controls to allocate the assets in the pooled accounts to the relevant beneficiaries, it would have to refuse to open such account [xviii].

The person who ultimately owns or controls the customer

Listed company

Listed companies are expressly excluded from the scope of the definition of “beneficial owner”. Where the customer or the direct or indirect owner of 25% or more of the shares of the customer is a company listed on a stock exchange and subject to disclosure requirements (either by stock exchange rules or through law or other enforceable means) which impose requirements to ensure adequate transparency of beneficial ownership, it is not necessary to identify and verify the identity of any shareholder or beneficial owner of such company [xviii].

Non-listed company

When the customer is a non-listed company, professionals are required, as part of their customer due diligence obligations, to identify and verify the identity of the natural person who ultimately owns or controls such company.

The 2004 Law sets out both quantitative and qualitative criteria for the identification of the beneficial owner of a company.

The quantitative approach (ownership + control)

The quantitative approach aims at determining the person(s) who directly or indirectly hold(s) 25% of the capital or voting rights in the company (contrôle de droit) [xvii].

The word “ultimately” in the legal definition of “beneficial owner” indicates that the said control or ownership can be either direct or indirect.

When layers of legal entities and/or arrangements are inserted between the individual beneficial owner and the customer, professionals must – based on the corporate structure provided by the client - determine whether the natural persons present at each level are likely to fall within the definition of beneficial owner.

Two approaches can be adopted for the calculation of the 25% threshold [xvii]:

- under a “top down” approach, the beneficial owner is the person who owns or controls at least 25% of the shares of the customer. In case of indirect ownership, the percentage is calculated by reference to the customer only. Hence, a natural person holding 50% of the shares of the customer’s “grand-mother company”, which in turn holds 60% in the customer’s “mother company”, will be considered as having an indirect ownership of 18% in the customer (30%x60% = 18%) and thus does not qualify as beneficial owner
- when a “bottom up approach” is followed, the beneficial owner will be the person who owns or controls at least 25% of the shares in the customer or any entity that owns at least 25% of the shares of the customer. Under this approach a person holding 30% at grandparent level of a 60% share at parent level in the customer is considered as beneficial owner of such customer.

The “bottom up approach” is generally followed in Luxembourg. This approach would also prevail in Europe if the proposal for a fourth anti-money laundering directive as released in February 2013 by the European Commission (the Fourth Directive Proposal) is adopted. Pursuant to said proposal, “a percentage of 25% plus one share shall be evidence of ownership or control through shareholding and applies to every level of direct and indirect ownership” [xix].

One should note at this stage that professionals must be flexible in the application of the above threshold. If a husband and wife each own 20% of the shares in the customer for instance, they could both qualify as beneficial owners. Such a situation is common. The relationship between shareholdings presents a high risk of money-laundering, identification and verification could also be extended to owners holding less than 25% of the shares of the customer.

The qualitative approach (ownership + control)

Shareholders holding at least 25% of the shares/voting rights of a company are deemed by law to control the company. However control does not automatically infer ownership. Besides, shareholders holding less than 25% of the capital of the company or any other person has control over the management, the administrative and governing bodies of the company or the company’s general meeting of shareholders ( contrôle de fait).

As stressed in the BIRD/The World Bank report “The Puppet Masters” (2011), “[…] this approach places the emphasis on determining who actually is guiding the relevant activity (of the client - corporate vehicle), rather than who theoretically possesses enough of a legal claim ‘to be able to do so’ [xviii].
Control can indeed be exercised by people in certain positions within the company (e.g. board members, executive officers (e.g. administrateur délégué, CEO)), who exercise day-to-day control.

Persons outside the company may also exercise (potential) control pursuant to contractual arrangements over the management of the client (e.g. creditors whose approval is required for specific transactions, holders of debt instruments that are convertible into shares of the company). These persons must be identified as part of the client identification process by asking the customer to disclose relevant information.

The lack of data on the ownership structure/control of companies or legal arrangements, however, makes identifying such persons very difficult. The Fourth Directive Proposal would help alleviate this problem for customers located in the territory of an EU Member State. Under the new regime, companies and trusts would have to retain information on their beneficial ownership and make this information available to competent authorities and relevant professionals. In addition, trustees would have to declare their status to the professional. This step forward to transparency will result in an increased administrative burden on Luxembourg corporate service providers.

**Investment funds**

A FCP has no legal personality. It is managed by a management company. Professionals likely to look for the beneficial owner(s) who meet either the definition of a natural person holding directly or indirectly more than 25% of the units in the fund (even though investors have no control on the management of the fund) or the definition of a natural person exercising a power of control over the asset management company representing the FCP.

**Investment company (Société d’Investissement à Capital Variable - Société d’Investissement à Capital Fixe)**

When the fund is constituted under the form of an investment company having a legal personality, the rules applicable to the identification of the beneficial owner of a non-listed company apply. If the fund is not self-managed, the assessment will also have to be made at the level of the management company. Specific attention must also be paid to open-ended investment funds i.e. those in which the equity interests issued may be redeemed at the option of the investor, as the holding of the units is likely to change on a regular basis.

**Legal arrangement - the concept of a trust**

A trust is not a separate legal entity. The client will be either the trustee or the settlor. Since no-one “owns” a trust, the 2004 Law defines the beneficial owner of a trust as the natural person who, directly or indirectly, (i) exercises control over 25% of the property of the trust or (ii) is a beneficiary of more than 25% of the property in the trust or foundation.

“Control” in relation to a trust has been defined in Ireland, for instance, as the “power (whether exercisable alone, jointly with another person or with the consent of another person) under the trust instrument concerned by or to, by law, to do any of the following:

1. dispose of, advance, lend, invest, pay or apply trust property
2. vary the trust
3. add or remove a person as a beneficiary or to or from a class of beneficiaries
4. appoint or remove trustees
5. direct, withhold consent to or veto the exercise of any power referred to in (i) to (iv) above” [xiv].

Several persons could qualify as beneficial owner of a trust:

- the trustee who manages the assets “on behalf” and hold them in trust
- the settlor who initiated the trust and contributed the assets
- the beneficiary (either determined or not) of the trust

Thus, it has been recommended in the presence of a trust to gather information on all relevant parties i.e. the settlor, the trustee and the beneficiary [xv].

It is also essential that the source of wealth is disclosed and independently verified.

The same analysis would apply to a foundation.

**Dealing with a beneficial owner**

**No autonomous legal status**

While being a central figure in the fight against money laundering and terrorist financing, the 2004 Law does not create a legal status for a beneficial owner. The former has no legal obligations under the anti-money laundering framework, but also no rights [xvi].

**No contractual relationship**

The fact that the professional has to identify the beneficial owner of its customer does not result in the creation of any contractual relationship between said professional and the beneficial owner [xvii].

As a consequence, a professional may reject any request for information made by a beneficial owner on grounds of professional confidentiality obligation/banking secrecy [xviii]. However, it has been upheld that information regarding the mere existence of a contractual/banking relationship between the customer and a professional can be disclosed to the beneficial owner [xix].

For the same reasons, the beneficial owner may not interfere in the relationship between the customer and the professional and must respect the structure that he has set up. In turn, creditors of the distressed/defaulting customers have no claim against the beneficial owner, unless they are able to prove the co-mingling of assets (confusion de patrimoine) between the customer and the beneficial owner or that the customer is a fictitious entity (entité fictive).

**Beneficial owner**

Beneficial owner refers to the natural person(s) who ultimately owns or controls a customer and/or the natural person on whose behalf a transaction is being conducted. It also includes those persons who exercise ultimate effective control over a legal person or arrangement.


[2] E.g. credit institutions, professional of the financial sector (PFS), insurance undertakings, pension funds, undertakings for collective investment, management companies, auditors, chartered accountants, lawyers, real estate agents...

[3] Article 3(2) of the 2004 Law


Beneficial owner refers to the natural person(s) who ultimately owns or controls a customer and/or the natural person on whose behalf a transaction is being conducted. It also includes those persons who exercise ultimate effective control over a legal person or arrangement.


[9] Tribunal d’arrondissement Luxembourg (16ème ch.), 17 avril 2008 (n° 1229/2008),


[12] Banque et droit 2010, Larcier, n°130, p. 6

[13] Banque et droit 2010, Larcier, n°130, p. 6

[14] Art. 3-1 of the 2004 Law

[15] Art. 3-2 of the 2004 Law

[16] Art. 22(1) of the CSSF Regulation N° 12-02 of 14 December 2012 on the fight against money laundering and terrorist financing


[xvi] Article 6 of the 2010 Grand-Ducal Regulation


[xix] Article 2 of the 2010 Grand-Ducal Regulation


[xxvi] Tribunal d'arrondissement Luxembourg, 19 novembre 2009 (n°113.809), Bulletin Droit & Banque, n° 46, novembre 2010, p. 33


[xxix] Cour d’Appel, 19 octobre 2011 (n° 35715)

About Ogier

Ogier provides practical advice on BVI, Cayman Islands, Guernsey, Jersey and Luxembourg law through its global network of offices. Ours is the only firm to advise on these five laws. We regularly win awards for the quality of our client service, our work and our people.

Disclaimer

This client briefing has been prepared for clients and professional associates of Ogier. The information and expressions of opinion which it contains are not intended to be a comprehensive study or to provide legal advice and should not be treated as a substitute for specific advice concerning individual situations.

Regulatory information can be found at www.ogier.com

ogier.com
Meet the Author

Fabien Debroise
Partner
Luxembourg
fabien.debroise@ogier.com
T+352 2712 2014
M+352 621 245 511

Key Contacts

Daniel Richards
Practice partner
Jersey, Luxembourg
daniel.richards@ogier.com
T+00 352 2712 2011
M+44 7797 779755

François Pfister
Partner
Luxembourg
francois.pfister@ogier.com
T+352 2712 2020
M+352 621 317 818

Laurent Thailly
Partner
Luxembourg
laurent.thailly@ogier.com
T+ 352 2712 2032
M+352 621 245 402

Related services
Banking and Finance