

Beneficial ownership and offshore structures — A Liechtenstein case study

This article presents some of the key anti-money laundering (AML) issues associated with beneficial ownership, especially in the offshore context. We conclude with a case study that suggests ways to add value to the Know Your Customer (KYC) process by applying creative research techniques and shrewd analysis.

The Third European Union (EU) Directive made identifying beneficial ownership a key area of focus. A beneficial owner is defined as the individual who ultimately owns or controls the customer and/or the individual on whose behalf a transaction or activity is being conducted. The beneficial owner is defined both for corporate entities and other legal entities.

The difficulty of identifying beneficial owners and the problem of how best to apply a risk-based approach have prompted numerous discussions among AML professionals. The limited transparency of offshore jurisdictions — in particular the meager disclosure requirements for corporate entities — may make it cumbersome and difficult to identify a beneficial owner.



Corporate Entities	Legal Entities
The natural person(s) who ultimately owns or controls a legal entity through direct or indirect ownership or control (> 25%) 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 stock market.	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.
	Where the individuals who 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.
The natural person(s) who otherwise exercise control over the management of a legal entity.	The natural person(s) who exercise control over 25% or more of the property of a legal arrangement or entity.

Also, within the context of a risk-based approach it is not always clear whether simplified due diligence or enhanced due diligence is required. Hence, a judgment call is needed. At this stage it is also important to highlight the risks of excessive reliance on information from potential or existing clients.

Generally, when beneficial owners are hiding behind nominees, intermediaries or other third parties, it can be assumed that the clients may not identify those owners. But even in cases where the ownership structure is clear and individual shareholders are named in company registers, the true identity of the beneficial owner may be different and the individual who claims to be the beneficial owner may just be a front man.

Individuals who disguise details relating to beneficial ownership are usually protecting their personal interests — unlike financial institutions, whose primary aim is to fulfill regulatory requirements. This divergence of interest leaves institutions exposed and vulnerable, since the interests being protected may not be legal. Structures set up to hide beneficial ownership are often very sophisticated and take extensive advantage of legal and regulatory loopholes.

The most recent prominent instance of an attempt to disguise beneficial ownership using foundation structures is the tax evasion scheme that initially emerged in Germany after the arrest of Klaus Zumwinkel, chief executive of the Post AG, a major publicly-listed company, in February 2008. According to German

authorities, hundreds of individuals in Europe, the U.S., Canada and Australia have set up foundations or trust structures in Liechtenstein for the purpose of tax evasion.

Compliance officers often feel uncomfortable about the lack of information available about clients, and have concerns about the independence and reliability of the information. But it is important for them to go beyond the tick-box exercise of merely collecting information and ask the “So what?” question. While unpeeling layers of corporate structure they must develop a picture and story around the target that makes sense. Does the proposed business make sense? What is the reputation and standing of the individual?

If the institution has doubts about the motives for the deal, or believes that the beneficial owner might be someone else and that the person claiming to be the beneficial owner is a front-man, then enhanced due diligence and in-depth investigative techniques can be brought to bear.

Enhanced due diligence - The methodology

In today’s business environment, beneficial owners — in particular with offshore structures — can be identified only through global investigative techniques. Online research techniques as presented by John Pyrik, CAMS (See *ACAMS TODAY*, January/February 2008, p.32) combined, if necessary, with further investigative techniques can add value to the KYC process.

The investigative process is based on the use, analysis and cross-checking of a myriad of sources, both documentary and

human, in the relevant jurisdictions. These must take account of business and legislative environments that vary from country to country and sector to sector. The more sophisticated the offshore structure, the more complex the investigation. That means local networks can be very helpful in furnishing regional expertise and local familiarity, which can be key in retrieving and analyzing, but more importantly, in putting the retrieved information into the appropriate context. One of the key elements of research and analysis is to look for inconsistencies and mistakes.

Searches should include not only the target company but also associated companies and possible links. All the individuals involved, including nominees, fiduciaries and other third parties involved in offshore structures, should be profiled. The information should then be matched with the details provided by the client in order to identify any inconsistencies and peculiarities. An example of inconsistency might be when a beneficial owner (client) declares not to have any assets. Research establishes that a nominee, who is listed as director of a number of corporate vehicles associated with the client, manages assets worth millions. It is possible that the client owns these assets.

A case study: Enhanced due diligence and beneficial ownership

Generally, investigations to identify beneficial owners of offshore vehicles are more likely to succeed when they are linked to true business activities. The market itself, and the regulations that

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companies operating in it have to follow, can be a valuable source of information.

The following case shows how the beneficial ownership of a complex network of German health care companies, with cross-ownerships and shareholdings associated with offshore vehicles incorporated in Liechtenstein and Luxembourg, could be identified.

Stiftung. However, since Prima Stiftung was a Liechtenstein registered foundation, it was impossible to substantiate this information with documentary evidence.

The allegations of an association with the Liechtenstein vehicle were strongly denied by Mr. Jack who, as a legal representative of Odeon, told the German stock exchange he had no knowledge of the ben-

Wave's shares, but it wasn't Mr. Jack. The owner was the Liechtenstein registered foundation, Prima Stiftung.

That warranted the following conclusion: If Odeon was owned by Mr. Jack through Wave, as he declared to the German stock exchange, then Prima Stiftung — which was the official owner of Wave, according to the corporate documentation retrieved in Luxembourg — had to be owned by Mr. Jack.

The more sophisticated the offshore structure, the more complex the investigation

The German companies had formed a consortium and were bidding in a public tender process. This group of companies had been successful in previous tender processes due to their competitive bidding prices. An international company, Alpha GmbH (Alfa), which retained a large percentage of market share, was also competing in the tender process. Alfa suspected that the German group could be tracked on an ownership level to one of Alfa's major competitors, Odeon AG (Odeon), a company listed on the German stock exchange. This would mean that Odeon was entering the tender process twice — once under its own name and once through the German group, in which it retained a stake. If so, it would have meant that Odeon was guilty of unfair competition, because it had failed to disclose its ownership-level relationship with the consortium.

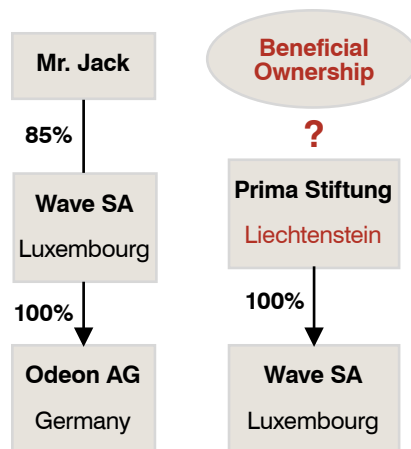
In order to either dismiss or confirm the suspicion, Alfa conducted an enhanced due diligence exercise to establish the identity of the beneficial owners of the network of companies.

A first-level due diligence consisting of searches and analyses of corporate documentation revealed that several of the companies were associated with one German company, called Acron GmbH (Acron), ultimately controlled by an offshore vehicle registered in Liechtenstein, called Prima Stiftung.

Alfa suspected that Odeon or its major shareholder — a Mr. Jack — could be the beneficial owner of these companies, retaining his stake through Prima

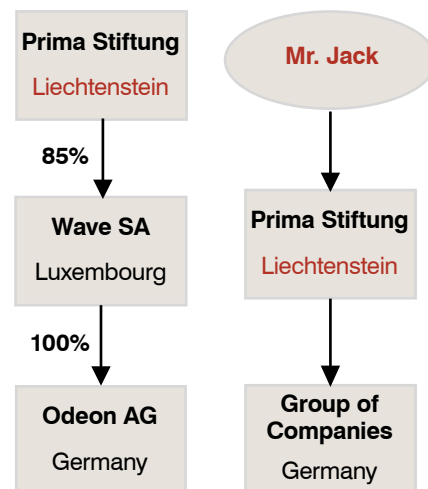
Stiftung.

On another occasion, Mr. Jack however, declared to the German stock exchange that Odeon was 85 percent controlled by him personally, through Wave SA ("Wave"), a company registered in Luxembourg. He said he held an 85 percent equity stake in Wave, which in turn controlled 100 percent of Odeon.




To the surprise of Alfa's representative, the declaration that Mr. Jack owned Odeon through Wave made it possible for investigators to uncover the identity of the beneficial owner of Prima Stiftung in Liechtenstein. How was it possible?

Retrieval and analysis of documentation from the company registry in Luxembourg revealed an inconsistency in Mr. Jack's statements. Research confirmed that a shareholder controlled 85 percent of



Consequently, and contrary to Mr. Jack's claims, it was possible to prove Mr. Jack's conflict of interest and anti-competitive practices.

Conclusion

It is therefore possible through creative investigative research techniques not only to be compliant with various legislative requirements but also to attain a good level of understanding surrounding the target and the businesses, and to really get to know the customer an institution is dealing with. Although it is often difficult to ascertain the beneficial ownership of companies and trust structures, the case study presented in this article shows how creative research and investigative approaches spanning a number of different jurisdictions can assist in answering even very difficult questions and shedding light on very complex structures. 

Jennifer Hanley, CAMS, managing director, Business Risk Research, Berlin, Germany, jennifer.hanley@business-risk-research.com

Nicoletta Grilli, managing director, Corporate Risk Watch, Milan, Italy, n.grilli@corporateriskwatch.com