

The Wolfsberg AML Principles Frequently Asked Questions with Regard to Beneficial Ownership

Questions sometimes arise with regard to the term “beneficial ownership” as used in the Global Anti-Money Laundering Guidelines for Private Banking (the “Guidelines”). Some of these questions, as well as answers, are noted below.

Q. 1. What does “beneficial ownership” mean?

A. The term “beneficial ownership” is conventionally used in anti-money laundering contexts, such as the Guidelines, to refer to that level of ownership in funds that, as a practical matter, equates with control over such funds or entitlement to such funds.¹ “Control” or “entitlement” in this practical sense is to be distinguished from mere signature authority or mere legal title.

The term reflects a recognition that a person in whose name an account is opened with a bank is not necessarily the person who ultimately controls such funds or who is ultimately entitled to such funds. This distinction is important because the focus of anti-money laundering guidelines – and this is fundamental to the Guidelines – needs to be on the person who has this ultimate level of control or entitlement. Placing the emphasis on this person is a necessary step in determining what the source of funds is.

What “beneficial ownership” is intended to mean for purposes of the Guidelines should be seen as dependent on the circumstances of the account involved. The Guidelines, therefore, do not seek to define the term “beneficial ownership” in the abstract; rather, the focus in the Guidelines is on identifying persons, in particular circumstances, who should be viewed as having the requisite “beneficial ownership”.

Accordingly, Paragraph 1.2.2 of the Guidelines begins with the general statement that beneficial ownership must be established for all accounts, but then qualifies this general principle by elaborating in the particular contexts of (i) natural persons, (ii) legal entities, (iii) trusts and (iv) unincorporated associations.

In the context of private banking relationships – which is what the Guidelines address – it should be noted that in circumstances in which the account holder is not a natural person, the general objective is to identify the natural person(s) who, ultimately, has the requisite beneficial ownership. In other contexts – e.g., business segments in which the clients are operating corporate entities with many shareholders – this objective, of course, would not make sense.

It may be worth clarifying that the term “identify,” as used above to mean the process of establishing which persons are to be viewed as having the requisite beneficial ownership, should be distinguished from the term “identification,” as used in the caption of Paragraph 1.2

¹ The term is used in relevant anti-money laundering regulatory guidelines. For example, the “Guidance on Sound Risk Management Practices Governing Private Banking Activities,” issued by the Federal Reserve Bank of New York in July 1997, refers to the person who establishes a personal investment company as the “beneficial owner” and also refers to “beneficial owners” of trusts and foundations. The term “beneficial owner” is also used in Article 3 of the (English translation of) the Agreement on the Swiss Banks’ Code of Conduct with Regard to the Exercise of Due Diligence (1998). However, the term is not defined in either document.

of the Guidelines, where it is used in the sense of establishing identity (through review, for example, of official identity documents).

Generally, for purposes of the Guidelines, it would be inappropriate to equate “beneficial owner” with “beneficiary” or “holder of any beneficial interest”. To define the term “beneficial ownership” in this manner would yield a result that is too inclusive. (Hence, the emphasis in Paragraph 1.2.2 is on the “principal” beneficial owners). See Questions 2-5 for a more concrete, practical approach.

Q. 2. What does the term “beneficial ownership” mean in the context of natural persons?

A. When a natural person seeks to open an account in his/her own name, the private banker should inquire whether such person is acting on his own behalf. If such person responds affirmatively, then, in the ordinary case, it is reasonable to presume that he/she is the beneficial owner.

There are circumstances, however, when this presumption may no longer be reasonable, that is, when “doubt exists” as to whether the apparent account holder is acting on his own behalf. In the client acceptance process, for example, such doubt could arise if there are inconsistencies in the information gathered in the due diligence process. For example, if a prospective client’s explanation as to the source of his/her funds does not, on its face, make sense, further due diligence would be appropriate.

Moreover, after the account has been opened, subsequent activity in the account may become inconsistent with the originally anticipated account activity, in which event, it may be reasonable to revisit the initial presumption that the account holder was acting on his/her own behalf. For example, if it is anticipated that the client, after the account is opened, will have occasional transfers of US \$100,000, and there are suddenly frequent transfers substantially in excess of that amount, further due diligence may be warranted, including further inquiry as to beneficial ownership.

Q. 3. What does “beneficial ownership” mean in the context of legal entities?

A. There are situations in which the account holder is a legal entity, but in which it is appropriate, for due diligence purposes, to understand who the beneficial owners of such entity are. For instance, a client of a bank may wish to organize a private holding company as a vehicle to hold assets; there may be advantages for doing so from an estate planning point of view in that corporate ownership of assets may eliminate estate taxes that might otherwise be imposed. Under these circumstances, the client is the beneficial owner of such company, and the appropriate due diligence would be done on this client, including background checks and inquiry as to source of funds. If appropriate, the banker should consider identifying the beneficial owner by reference to official identity papers.

Of course, in the case of a corporate entity that is a typical operating company with many shareholders, it would make no sense to do due diligence on the shareholders. Indeed, this type of entity would not ordinarily have a relationship with a Private Bank because such a client is institutional or commercial in nature and would presumably have relationships with other business units of the Bank.

There may be situations where there are more than one principal beneficial owner. For instance, a successful entrepreneur may organize a private holding company in which he and

his spouse are the shareholders, but in which he is the provider of funds. In this situation, due diligence as to the source of funds should be done on him, not his spouse. It may, however, be appropriate, to engage in some due diligence with respect to the spouse's background and reputation.

It is appropriate for the private banker to develop an understanding of the company's structure. In the event, for example, there are shareholders owning a substantial amount of shares who are not related to the apparent provider of funds, the private banker should seek to understand why this is so. Similarly, if there are individuals who are in a position to exert control over the funds held by the company (e.g., directors or persons with power to give direction to the directors), and such individuals are not related to the apparent provider of funds, the private banker should consider why this might be so. In these types of situations, this further inquiry may disclose that the apparent provider of funds is not to be viewed as the beneficial owner with respect to such funds. If so, the focus of due diligence should be redirected to the beneficial owner, or indeed, the propriety of opening an account at all may be called into question.

Q.3A. What implications, if any, are there, if corporate entities are not legally required to disclose, as a matter of public record, who their ultimate beneficial owners are?

A. There may be situations in which applicable law does not require corporations to disclose publicly (e.g., in a registry) who their beneficial owners are. If such a corporate entity were a potential client of the Private Bank, such law would not preclude, as a matter of anti-money laundering due diligence, an understanding of the beneficial ownership of the company. The private banker should conduct the appropriate due diligence with respect to the principal beneficial owners, regardless of the disclosure laws applicable to the company.

Q. 3B. What implications, if any, are there if shares are held in bearer form?

A. The mere fact that shares are in bearer form does not preclude the usual due diligence on the beneficial owner of such shares; the due diligence to be done on an owner of registered shares and an owner of bearer shares is the same. The initial inquiry should be as to who is the beneficial owner of the shares; in the case of registered shares, it is apparent, by definition, who the nominal shareholder is; in the case of bearer shares, a bank may require certification as to beneficial ownership at the outset of the relationship and when there are changes in ownership structure.

Q. 4. What does "beneficial ownership" mean in the context of trusts?

A. In the typical case, it would be clear which person has "beneficial ownership" for purposes of the Guidelines. For instance, in the case of an industrialist who establishes a trust for the benefit of his wife or minor children, the "beneficial owner" would be the industrialist settlor, namely, the "provider of funds," as contemplated by Paragraph 1.2.2 of the Guidelines. The appropriate due diligence should be conducted with regard to the industrialist, including background checks and the requisite inquiry as to source of funds. If appropriate, the banker should consider identifying the beneficial owner by reference to official identity papers.

Even though the wife or children have a beneficial interest in the trust, they should not be treated as "beneficial owners" for anti-money laundering purposes. That is, it would not make sense to do due diligence with respect to the wife's or children's source of funds, although it may be appropriate to do some due diligence with respect to their background and reputation.

The fact that the settlor is deceased does not preclude the need for due diligence with respect to his/her reputation and source of wealth. In this regard, it is presumptively reasonable to look to the trustee for information regarding the source of wealth, assuming the trustee is reputable.

Q. 4A. Why is it appropriate for the private banker to understand who has control over the funds held in the trust structure or who has the power to remove to the trustee, even if the person having such control or power is not the source of funds?

A. If there is a person who has this level of control or power, it is appropriate for the private banker to seek an explanation for this arrangement, and to undertake further inquiry, if, on its face, the arrangement is not plausible.

Moreover, a person who has this level of control or power may present reputational risk to the Bank, even if the ultimate explanation for the arrangement is plausible, and due diligence as to such person's reputation is warranted, if such person is not already known by the Bank to be reputable.

Q. 4B. What should the private banker review in seeking to understand the structure of the trust sufficiently for purposes of 1.2.2?

A. The private banker may rely on declarations or attestations given by the trustee as to the "provider of funds, those who have control over the funds (e.g., trustees) and any persons who have the power to remove the trustees" if the trustee is an institution or individual who is well-known to the private banker. If the private banker is not familiar with the institution or individual, then the private banker should undertake due diligence with respect to such institution or individual with a view to establishing a basis for reasonably accepting such declaration or attestation. It is not necessary for the private banker to obtain a copy of the trust instrument.

Q. 5. What does beneficial ownership mean in the context of unincorporated associations and partnerships?

A. Establishing beneficial ownership in the context of unincorporated associations and partnerships generally entails the same principles as discussed above.

Partnerships. Ordinarily, the principal general partners would be considered to be the "principal beneficial owners" for purposes of Paragraph 1.2.2. Again, the focus is on the provider of funds. In the event there are many limited partners having relatively small stakes, there would be no need to do due diligence with respect to them, just as there would be no need to do due diligence on investors in a pooled fund managed by a client of a bank.

Foundations. In some jurisdictions, "foundations" may be used by clients as investment or wealth planning vehicles, much as private holding companies are used for such purposes in other jurisdictions. The private bankers should understand who the founder (typically, the client) is. The private banker should do so even if the identity of the founder (i.e., the source of funds) is not discernible from the public record.