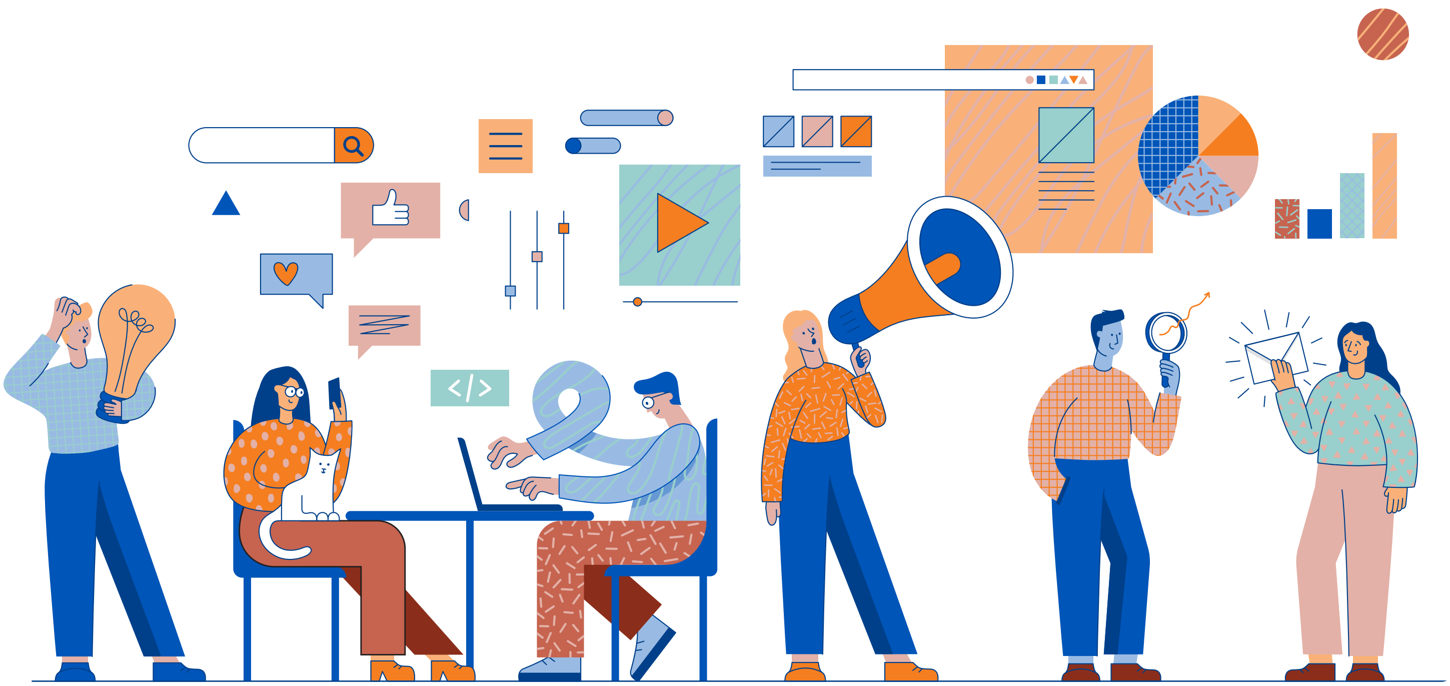
WHITEPAPER



Beneficial Ownership Series

Introduction to Beneficial Ownership

Today's business landscape is marked by organizations expanding through networks of vendors, resellers, suppliers, partners and other third parties, each delivering opportunity as well as risk. Understanding the potential magnitude and impact of each is critical for doing business.

Recently, multiple anti-corruption agencies around the world have strengthened their third-party risk management guidance, requiring firms to gain a better understanding of who truly owns the third parties with which they enter into agreements. Unsurprisingly, ownership structures within third parties may be complex and obfuscated, creating numerous opportunities for corruption and lawbreaking.

To maintain an ethical and successful company within this landscape, it has become imperative for organizations to understand with whom they are doing business. Determining beneficial ownership – a term which refers to the person who ultimately enjoys the benefits of ownership even if the entity or property is in another's name – has long been particularly elusive and difficult to ascertain, yet it is a key piece of the compliance puzzle. Too much is at stake for companies to forego collecting this information, as poor beneficial ownership verification protocols can have serious repercussions.

Considering the significance of third-party risks, many companies are rapidly moving toward automated due diligence systems. The ability to centralize beneficial ownership records within these solutions is essential for companies to assess and manage their third-party risks.

This document illustrates the importance of verifying the ownership of the businesses with which your company interacts, and explores the complexities surrounding beneficial ownership. In a follow-up paper, we will demonstrate how advancements in digital technologies can assist in solving your company's verification challenges and how using data and analytics can improve the speed and accuracy of beneficial ownership identification.

WHY BENEFICIAL OWNERSHIP INFORMATION IS IMPORTANT

Beneficial ownership refers to the natural person or persons who ultimately own the company or third party in question.[1] The term may also refer to those natural persons who exercise ultimate effective control over a legal entity, including through board positions, senior management positions, shareholder agreements on voting rights, financing structures, and even family relations. The beneficial ownership inquiry thus boils down to questions of power and control, asking who ultimately benefits from the third party's relationships, revenues and successes.

As cross-border relationships have grown in size and scope, so too has the complexity of accurately assessing entities' beneficial owners and the consequences of failing to properly do so. Bad actors can, and have, exploited more sophisticated business structures to cover up their identities and crimes.

Government regulators, meanwhile, increasingly demand that companies clearly identify and understand with whom they are doing business. Modern compliance regimes, especially those in the anti-corruption, sanctions and anti-money laundering spaces, mandate that your company collect and analyze beneficial ownership information. Last year, the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) issued new guidance that explicitly labeled identifying ownership as one of the "fundamental components of an effective OFAC risk assessment."[2] A company's failure to do so can have lasting repercussions.

Given this, it is critical that your company know whom it is actually doing business with to better understand the level of risk each third party represents as a whole – not just knowing the outside entities' names or officers, but the people who ultimately own, control and profit from them.

THE VALUE OF BENEFICIAL OWNERSHIP RECORDS

One major challenge risk and compliance professionals face is explaining why beneficial ownership should be a concern and why company resources should be devoted to addressing it. The case for obtaining beneficial ownership information begins with an explanation of the likely consequences of failing to address it.

Beneficial ownership information mitigates corruption risks by exposing government ownership

Your company's third parties may be partially owned by government officials or politically-exposed persons ("PEPs") as a means of securing or laundering illegal proceeds. Government owners are known red flags, and their involvement – however small – could be helping to further criminal activities.

Too many U.S. Foreign Corrupt Practices Act (FCPA) enforcement actions involve scenarios where the company does business with a third party only to later discover that they are owned by a government official, and that payments to the third party were in fact thinly veiled bribes. Accordingly, companies must drill-down on third parties' ownership structures to reveal the presence, or confirm the absence, of such actors.

Companies that obtain certifications for lack of government ownership from their third parties may reduce the associated risks but fail to eliminate them, as government owners may seek to actively conceal their ownership interests. Therefore, beneficial ownership information should be independently verified. Without complete beneficial ownership information, your company is taking significant risks when it comes to FCPA compliance.

Beneficial ownership information mitigates sanctions risks by exposing sanctioned individuals and entities

In the economic sanctions context, obtaining beneficial ownership information is critical due to the prevailing legal inquiry, which OFAC has dubbed the "50 Percent Rule." Based upon U.S. diplomatic and foreign policy objectives, OFAC maintains a list of individuals and entities with whom U.S. companies are prohibited from doing business. Under OFAC's 50 Percent Rule, any entity that is at least 50 percent owned by a prohibited person or entity (or by a combination of prohibited persons or entities) is also considered a prohibited entity.

Adding to the challenge, many of OFAC's sanctions programs, especially those targeted at countries like Russia, Iran and Venezuela, are dynamic and subject to change at any moment (especially in today's volatile political climate). Additionally, sanctioned individuals or entities may seek to disguise their ownership interests to circumvent sanctions and escape detection. With all of this uncertainty surrounding the scope and applicability of international sanctions, your company must verify its third parties' beneficial ownership information in real time (not just once, but continuously).

Beneficial ownership information mitigates money laundering risks

Ensuring that your company guards against money laundering activities also requires the identification of beneficial owners. Often, unfamiliar companies may make payments to your company on behalf of existing customers or third parties. This is not uncommon, and it typically involves high-risk entities with unknown ownership structures.

In some cases, these unfamiliar entities may be engaging in financial transactions to launder the proceeds of illegal activities. Your company may be unwittingly facilitating trade-based money laundering schemes in which known criminals disguise illicit payments as ordinary business transactions.

Although most customers and third parties are law-abiding companies, terrorists, traffickers and corrupt government officials have been finding more sophisticated ways of funding themselves through legitimate financial networks.

Beneficial ownership mitigates reputational issues

Maintaining a positive public image is critical to your company's continued success. Even the perception of engaging in nefarious business practices can negatively impact your company's brand and industry reputation, which can cost vastly more than any potential enforcement action and take years to recover from (if ever). Even the unintentional association with malicious actors can have harmful effects. For instance, if a vendor's beneficial ownership structure includes a sanctioned individual, but that individual's ownership stake is not large enough to trigger OFAC's 50 Percent Rule, the presence of that ownership interest still poses dangerous reputational risks. This type of news may damage investor and supplier relations and hinder both current and future business partnerships.

Additionally, modern consumers are far more informed than ever before, and they demand high ethical standards from the companies they frequent. As business writer Richard Young notes, "In some cases, stakeholders are filling the spaces left by relatively light regulatory enforcement…[filling] the gap left by regulators hampered by jurisdictional or procedural questions in a range of areas – ready to flag up even suspected breaches with considerable commercial consequences."[3]

Given the vast importance of this public and private trust, the failure to properly identify the actual people behind the third parties that your company deals with simply is not worth the risks.

In the next installment of the **Beneficial Ownership Series**, we will review the steps for solving the complexities and challenges of identifying beneficial ownership and channeling it through your third-party risk management and due diligence solution.