PACIFIC STRATEGIES & ASSESSMENTS

Due Diligence
Investigations
Advisory

PSA BRIEF:

Uncovering Beneficial Ownership in Third-Party Due Diligence

JULY 2020

© 2020 Pacific Strategies and Assessments | All Rights Reserved

Who Owns Your Third Party? Why you should want to know

Understanding who owns your third party is an increasingly important part of due diligence, and best practices are evolving towards obtaining more ownership information. An accurate understanding of the ownership of a counterparty can help identify risks such as:

- **Hidden PEPs or government shareholding (FCPA risks)**
- **Sanctions (OFAC risks)**
- **Collusion and Conflicts of Interest**

Unfortunately, there are often barriers to obtaining official ownership information, with disclosure requirements and information availability varying greatly around the world. This necessitates a risk-based approach—obtaining as much information as is reasonable and proportional to the risk profile of the third party. Where barriers are encountered, the costs of obtaining ownership information must be balanced against transaction and geographic risks or other risk profile information. Where official information is completely unavailable, source commentary or targeted media research can establish an unofficial record of a high-risk third party's ownership.

This brief explores some risks that can be averted through beneficial ownership research and outlines the many barriers to uncovering ownership information. It concludes with a discussion of how a range of research and investigative options can support an agile, risk-based due diligence program.

Guidelines for Pursuing Beneficial Ownership in Due Diligence

- Remember that in many countries full information may be within easy reach for an appropriately scoped due diligence report.
- Consult with your due diligence provider about barriers to accessing ownership information and then reassess priorities and expectations.
- Apply a risk-based approach to reasonably balance risks, requirements, and resources for each third-party.
- For high-risk subjects, apply additional resources like source commentary to make up for a lack of official information.

Ownership Risk: Hidden PEPs and SOEs

FCPA enforcement risk is one of the most significant concerns behind third-party due diligence. The statute makes it critical to identify not only any potential government officials among third parties, but also state-owned enterprises. This is because employees of SOEs or other entities deemed subject to government control may also be considered "foreign officials" subject to FCPA prohibitions.

In many cases, government control may be established by a visit to the entity's website, database searches, and formal filings recovery. However, in many jurisdictions additional media research may be required to piece together SOE ownership structures because numerous companies may be interposed between a government entity and its subsidiaries. In these cases, the SOE status of a subsidiary may not be detected in big-data or "AI" sweeps of stale corporate information.

More challenging cases arise when ownership by a PEP is deliberately obscured for the purposes of tax evasion, money laundering, or bribery. In such cases this information will inevitably be difficult or impossible to obtain through searches in official records. However, careful analysis of extensive records searches, media research, and court records can help identify the bigger picture. Most powerfully, the scope of research can be extended through on-the-ground collection of commentary from human sources familiar with the entity and its behavior.

In a recent matter, due diligence was conducted on a Balkan company that appeared to be barely operational but was the intermediary in a series of large infrastructure projects in its home country. In mapping the ownership, the trail ended abruptly at a Luxembourg holding company whose ownership information could not be determined through records retrieval. Abandoning this avenue, PSA initiated a series of discreet source inquiries in the Balkans, working with local investigative journalists. These sources were able to provide substantial testimony and evidence that the entity was ultimately owned by a high-ranking public official. This official controlled the allocation of large public infrastructure projects, and reportedly used this entity as a conduit for gathering bribes from project bidders.

Ownership Risk: Sanctions

OFAC sanctions have long been a critical consideration when engaging third parties and identifying beneficial ownership has equally emerged as an essential tool for identifying sanctions risks. Under OFAC's "50% rule," if a subject entity is at least 50% owned by a sanctioned entity or entities, it should be considered blocked as well, even if the subject itself is not listed. This rule also applies in the aggregate if the shareholding of multiple sanctioned entities adds up to at least 50%. Because of this rule, a simple check through OFAC's lists may fail to identify critical risks.

In 2014, the US government Office of Foreign Asset Control (OFAC) imposed Crimea-related sanctions on numerous Russian entities and individuals, many of which own and control vast empires of affiliates and subsidiaries located outside of Russia. These Crimea sanctions combined with the 50% rule to create a vast new pool of potentially risky counterparties. PSA has identified numerous instances in which the potential counterparty was over 50% controlled by a sanctioned individual, but numerous due diligence matters have also resulted in the discovery of some creative "alternative" structures that have allowed sanctioned persons to engage with international financial networks.

In one such case, an individual associated with a holding company in an offshore jurisdiction was suspected of being the son of a sanctioned individual, although database searches did not flag him as such. For a number of reasons, including a misleading transliteration of his name from Cyrillic to Latin characters, this relationship could not be established through further desktop research. However,

sources with knowledge of the subject not only identified the family connection but also described the holding company as linked to the Russian business of the sanctioned father. The son was widely recognized to have come to the offshore jurisdiction to facilitate transactions on behalf of his sanctioned father—presenting significant sanctions risks to any parties engaging with him.

Additional Risks: Collusion and Conflicts of Interest

In the course of collusion investigations, it is common to discover shared ownership between the perpetrators. Fraud cases often hinge upon a conflict of interest presented by the business interests of a client's employee. Proactively making such efforts can be an important part of managing third-party risks. Our clients routinely task us with identifying the beneficial ownership of third parties as part of onboarding due diligence—sometimes for selected high-risk entities and sometimes even for all third parties. By doing so, these clients can make their third-party datasets more robust and capable of spotting patterns of risk and identifying issues that require remediation.

The Problem of Unofficial Ownership

Sometimes the true beneficiaries of a company—usually PEPs—do not maintain their ownership status in any formal way. Experts estimate that vast amounts of wealth are held worldwide by owners who are completely off the books. In such cases, no amount of records availability will help, yet engaging with such companies can present significant regulatory and sometimes political or operational risks.

In some jurisdictions it is not uncommon to find that a company's ownership appears straightforward on paper, but allegations from anonymous sources or investigative journalists allege that the third party is really owned by a powerful politician.

A recent due diligence report on a former SOE in a CIS country revealed several ownership anomalies. Multi-jurisdiction records collection indicated that the company was majority-owned by a former government official of the CIS country along with a handful of holding companies registered in the British Virgin Islands. The subject company was registered as nothing more than a branch of a BVI company despite being a former "national" company in the CIS country. More puzzling was the fact that the only identified natural owner of the company, the former official, was reported in local media to have been "fired" from his own company by a current high-level government official—suggesting his ownership of the company was purely nominal.

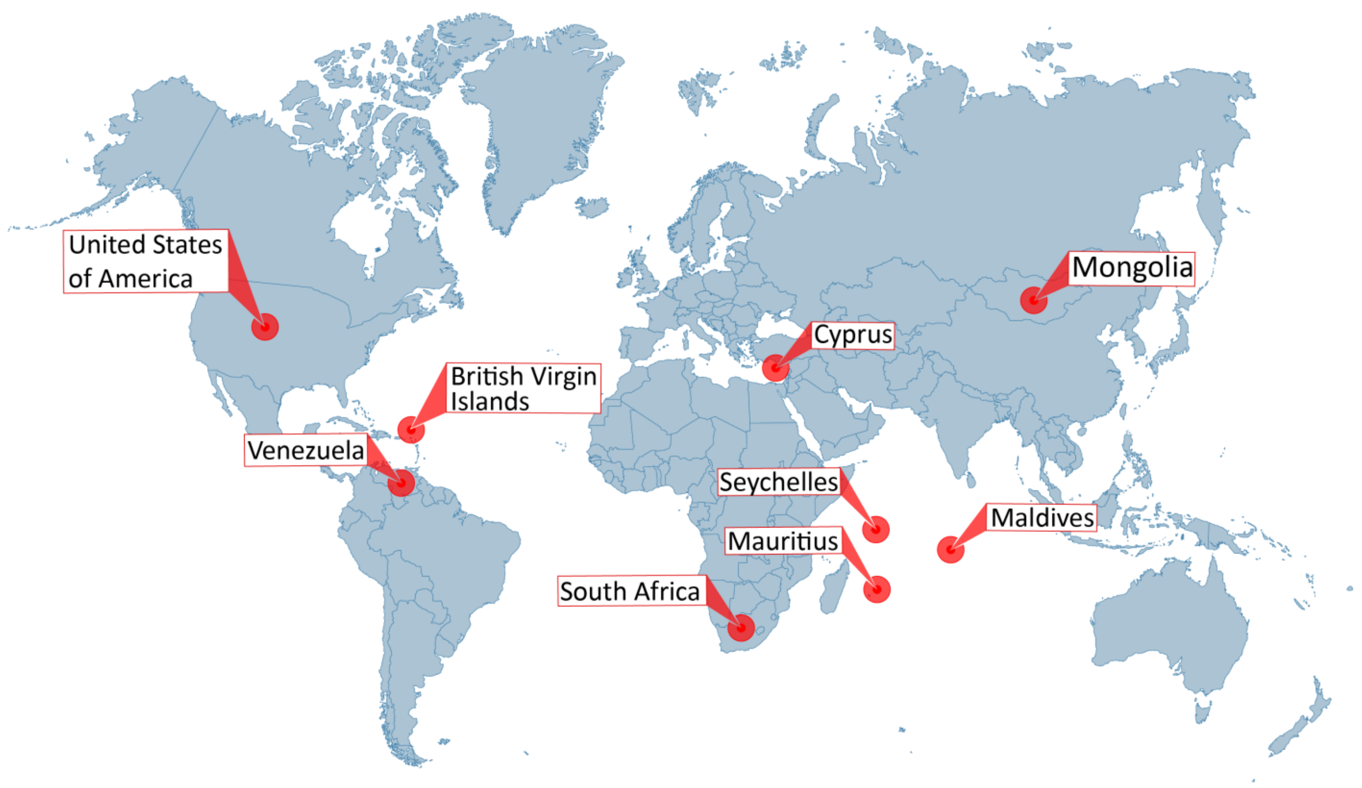
While source commentary was ruled out in this inquiry, desktop research discovered revealing US regulatory documents and works of investigative journalism detailing a frequently shifting web of ownership by holding companies mostly associated with the current official who had reportedly dismissed the company's owner. It was determined that this figure likely controlled the company. While this fact could not be decisively confirmed within due diligence research, the combination of a significant lack of transparency and a wealth of circumstantial evidence pointed to significant FCPA and money laundering risks.

Obstacles to Identifying Beneficial Owners

In an ideal world, identifying the beneficial owners of a company would require nothing more than a search of corporate registration information. Some countries such as the United Kingdom have moved towards ownership transparency through mandatory registries of beneficial owners. The EU has mandated the gradual implementation of such registries among its member states and the US Congress is currently considering similar measures—although in the US and many EU member states the degree of access that private citizens will have to these registries is still being debated.

However, in many important jurisdictions throughout the world, ownership records are either nonexistent or prohibitively difficult to access. An assessment internal to PSA estimates that about one-third of all countries fit into this category. While opaque "offshore" jurisdictions like the British Virgin Islands, Cyprus, or Mauritius receive much attention in connection with tax evasion or money laundering scandals, many significant jurisdictions—including the United States—simply do not require disclosure of beneficial owners except in the case of publicly traded companies.

Challenging Jurisdictions for Identifying Beneficial Ownership



Common Challenges in Accessing Ownership Information

Around the world, due diligence researchers encounter a wide range of obstacles to uncovering beneficial ownership. Some of these are routinely overcome, while others make obtaining official documentation of ownership effectively impossible.

- Records must be retrieved in person from a government office
- Corporate records are incomplete, unreliable, or outdated
- Proof of citizenship is required to obtain records
- Records are only available to law enforcement or parties to litigation
- Records only list nominee shareholders
- Records are only maintained for some categories of companies
- The counterparty's authorization or special power of attorney is required to obtain records
- Onerous fees are charged for records retrieval—this can become cost-prohibitive where owners hide behind multiple layers of shell companies
- No ownership information at all is maintained in corporate records

Implementing a Risk-Based Approach

There is no one-size-fits-all approach to identifying beneficial ownership. Because the availability of information varies so widely from one country to the next, risk-based decisions must be made about how extensively to pursue ultimate natural ownership in the course of due diligence. Fortunately, a spectrum of options is available, and due diligence providers like PSA can help tailor an approach at the appropriate intersection of the third party's risk profile and the information available in the jurisdiction.

In relatively transparent jurisdictions, most ownership information can be recoverable through baseline due diligence services. Research in more challenging jurisdictions may include a more synthetic assessment of available media, pay-for-access records searches, and inquiries into multiple layers of ownership and/or searches in additional jurisdictions. Efforts in the most challenging jurisdictions often involve soliciting commentary from local experts and individuals familiar with the subject.

Risk-based decisions can also inform the depth of inquiries, not just the methodologies. For example, where fully peeling away multiple layers of ownership becomes cost-prohibitive, searches may be curtailed after 50% of ownership is accounted for, or other predetermined criteria are met. Conversely, PSA can increase the scope of due diligence requests after concerning information is found to allow for more targeted ownership research. Adaptability and responsiveness are key to successfully executing a risk-based approach.

No due diligence provider can promise to identify ultimate beneficial ownership in all jurisdictions, no matter how deep it digs. However, PSA can provide expert knowledge about what information is available where and extend significant information gathering capabilities throughout the world. Compliance professionals that work with their due diligence provider to capitalize on these capabilities can achieve a better match between effort and need and make the most of their compliance budget.

To learn more about PSA's third-party due diligence capabilities visit www.psagroup.com/3pdd.

info@psagroup.com
www.psagroup.com

Better Intelligence

HONG KONG
Unit 1206, Level 12, BOC Group Life Assurance
Tower, 134-136 Des Voeux Road, Central, Hong Kong
Telephone: +(852) 3972 6503
Fax: +(852) 3972 5777

MANILA
Suite 6, Level 36, Tower 1, The Enterprise Center
6766 Ayala Avenue corner Paseo de Roxas, Makati
City 1226, Philippines
Telephone: +(63) 2 843-6856

SHANGHAI
Suite 2104, One Prime Building
1361 Sichuan North Road,
Shanghai 200080, P.R.C.

DUBAI
1912 Goldcrest Executive Tower,
Jumeirah Lake Towers, PO Box 112911,
Dubai, United Arab Emirates
Telephone: +971 04 568 2247

Pacific Strategies & Assessments (PSA) is a global specialist risk consultancy, delivering critical information to our clients through our three core service lines: Due Diligence, Investigations, and Advisory services. We operate where our clients do business, with regional offices staffed by investigators and responders who have extensive in-region experience gained from professional backgrounds in corporate investigations, government intelligence and law enforcement.