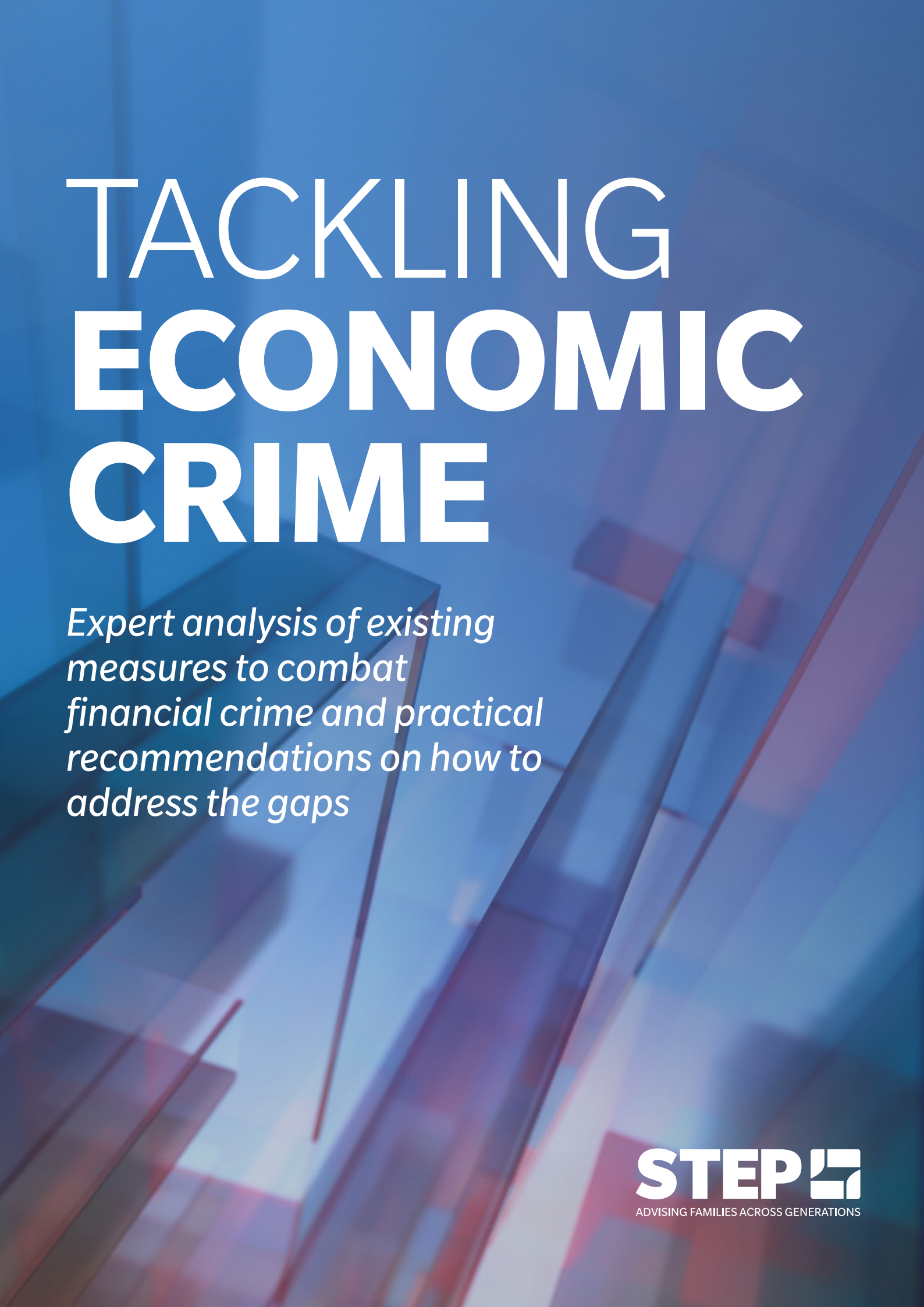

TACKLING ECONOMIC CRIME

Expert analysis of existing measures to combat financial crime and practical recommendations on how to address the gaps

STEP

ADVISING FAMILIES ACROSS GENERATIONS

TACKLING ECONOMIC CRIME

Expert analysis of existing measures to combat financial crime and practical recommendations on how to address the gaps

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About STEP

STEP is the worldwide professional association for those advising families across generations. We promote best practice, professional integrity and education to our members. Our members help families plan for their futures: from drafting a will or advising family businesses, to helping international families and protecting vulnerable family members.

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ACKNOWLEDGEMENTS

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INTRODUCTION

In national and global media, private wealth structuring vehicles often make headlines for facilitating economic crime in the form of tax evasion, abusive tax practices, money laundering and terrorist financing. In the Panama, Paradise and Pandora papers, it has been arrangements such as trusts and similar vehicles that have caused the most sensation. However, these unethical practices are the exception rather than the rule when it comes to private wealth.

In most common-law countries, trusts are very common and used for a wide range of everyday purposes, from pensions and charities to life insurance and home ownership. Many people include a trust in their will to help pass on inheritances, particularly when the intention is that funds will be used to help young children or grandchildren not yet able to look after their own affairs. Trusts are also often used to enable continuity of businesses following the death or incapacity of an owner, or to manage assets for incapacitated individuals. In the US, a revocable living trust is commonly used in place of a will to avoid the necessity of probate, saving families from expensive probate proceedings and allowing assets to be transmitted to beneficiaries faster.

Globally, there are therefore many millions of trusts used for fully legitimate and lawful purposes. A criminal minority tarnish the reputation of the industry as a whole and it is essential that we identify and address the weak areas that are facilitating this.

Developing practical, effective solutions

STEP, as a global professional body comprising lawyers, accountants, fiduciaries and other practitioners who specialise in trusts and estates, has a key role to play in tackling this issue. We set and uphold standards for our members and engage with governments on technical and policy issues, informing legislation and regulation, and helping implementation through developing practical guidance for our members. Our members' significant practical expertise assists in creating workable and effective solutions.

We abhor the misuse of financi al vehicles such as trusts for the purposes of financial crime and tax evasion and fully support the need to improve transparency and encourage rigorous safeguards that will help to combat financial crime.

We are keen to work with governments and international bodies to find solutions that are practical and result in effective measures to combat evasion and further the fight against criminal or terrorist financing.

Building on what has come before

In considering the most effective means of tackling economic crime, it is important to have clarity on the measures that have already been introduced and how these are working in practice.

Over the past decade, a range of transparency and anti-money laundering (AML) initiatives have been introduced to tackle economic crime. As a result, many of those working in or with the trust industry, including obliged entities setting up and administering trusts and those advising and entering into business arrangements with trusts, are required under their own AML rules to carry out appropriate due diligence with respect to the trust and its beneficial owners. These obligations have made it

increasingly difficult for individuals seeking to use trusts to hide assets or launder money.

This does not mean that those working in and with the trust industry can now relax. It is increasingly important that our stakeholders remain vigilant and up to date on new measures being introduced to combat the use of trusts for criminal purposes.

In this paper, we aim to:

1. Explain the existing initiatives in place to counter the use of private wealth structuring vehicles to facilitate economic crime.

2. Explain best practice as to how these initiatives can most effectively be implemented.

3. Suggest further measures to tackle economic crime in this sphere.

EXISTING INITIATIVES

EXISTING INITIATIVES: TAX TRANSPARENCY AND AEOI

Over the past decade, multiple transparency regimes have been introduced to combat the misuse of both financial vehicles and professional advisors to facilitate economic crime. This category of measures focuses on transparency and the automatic exchange of information (AEOI) between different jurisdictions' tax authorities.

FATCA

The United States (US) enacted the *Foreign Account Tax Compliance Act* (FATCA) in 2010 to target non-compliance by US taxpayers using foreign accounts. FATCA requires that non-US banks and other foreign (i.e., non-US) financial institutions (FFIs) obtain information about US account holders and beneficial owners.

FATCA reporting takes two forms, and both are deemed intergovernmental agreements. The first is Model 1, which is where FFIs in non-US jurisdictions report information about the account and the US account holders and beneficial owners to their tax authorities, which subsequently pass the information to the US.

The second is Model 2, where the FFIs report the account information directly to the US. The majority of jurisdictions that participate in FATCA have signed Model 1 intergovernmental agreements. Unfortunately, this system is not reciprocal and which, in many respects, is a lost opportunity.

CRS

The Common Reporting Standard (CRS) was designed by the Organisation for Economic Co-operation and Development (OECD) in May 2014 following a request from the G20. It is a method of exchanging financial information between jurisdictions to combat tax evasion. It achieves this by being a mechanism for the mandatory automatic exchange of financial information between jurisdictions.

The CRS requires all financial institutions (FIs) operating in participant countries to gather account information (including information about account holders and beneficial owners) and provide it to their local tax authorities for exchange with the tax authorities in the jurisdiction of residence of the account holders and beneficial owners.

CRS measures have yielded positive economic results for governments. For example, the UK's HM Revenue and Customs (HMRC) recorded a 14% rise in recoveries between 2018 and 2019 compared to the previous year, with a total estimation of GBP36.9 billion from tax compliance measures.

Disclosure under FATCA and the CRS in relation to trusts

Both FATCA and the CRS require disclosure of information about beneficial owners of trusts. For example, a professional trust company may be an FI, and in this case will be under an obligation to disclose information to its local tax authorities (or the IRS if it is in a Model 2 jurisdiction) about the beneficial owners and controlling persons of the trust. In addition, information may be reported in other ways. For example, where a trust invests into a financial account through a passive entity, the FI managing the financial account will be under an obligation to obtain relevant information about the beneficial owners and controlling persons of the passive entity and the trust and to report this information to the relevant tax authorities.

Information about a trust disclosed under FATCA and the CRS includes information about (i) settlors; (ii) beneficiaries; (iii) protectors; (iv) trustees; and (v) other natural persons exercising effective control over the trust.

The report also provides financial information, including information about the value of the trust

assets and the value of distributions and benefits made or provided to beneficiaries.

This financial information and information about the beneficial owners and controlling persons is automatically shared with the tax authorities in the jurisdiction of residence of the beneficial owner or controlling person. Both FATCA and the CRS therefore provide for the automatic exchange of information to tax authorities about the value of assets settled into trust by a settlor resident in that jurisdiction and the value of benefits provided to beneficiaries. This enables the tax authority to determine whether the appropriate amount of tax is being paid.

Mandatory Disclosure Rules

In 2017, the OECD published a consultation document outlining its new Mandatory Disclosure Rules (MDR) for the CRS. The rules were proposed as a means to address arrangements either designed to circumvent reporting under the CRS or aimed at providing beneficial owners with the shelter of non-transparent structures.

The finalised rules were published in March 2018. The aim of the MDR is to ensure that tax authorities are aware of any arrangements designed to circumvent the application of the CRS or arrangements involving opaque offshore structures designed to conceal the true beneficial owner. The MDR require a user of, or an intermediary involved in, these arrangements to disclose certain information to the user's or intermediary's local tax administration about these arrangements, including information about the taxpayers and beneficial owners who potentially benefit from such arrangements.

Where such information relates to users that are resident in another jurisdiction, the rules state that it should be automatically exchanged with the tax administration(s) of that jurisdiction in accordance with the terms of the applicable international legal instrument.

DAC6

Council Directive (EU) 2018/822 (Directive on Administrative Cooperation in the Field of Taxation (DAC6)) entered into force in June 2018.

DAC6 requires EU intermediaries that design or promote cross-border tax-planning arrangements or (similar to the MDR) arrangements designed to undermine the CRS or conceal beneficial ownership to report information about the arrangement to their local tax authorities. This includes information about those involved in implementing the arrangement and the end user.

Any information received by EU Member States is automatically exchanged with other EU countries through a centralised database.

The directive sets out several hallmarks that must be satisfied for the arrangement to be required to be disclosed. Some of these include a main benefit test for establishing whether the arrangement is aimed at obtaining a tax advantage.

Additionally, hallmarks also cover similar arrangements to those under the MDR. Such arrangements are designed to circumvent the application of the CRS or conceal beneficial ownership by the use of non-transparent legal or beneficial ownership chain of persons, legal arrangements or structures.

Disclosure under the MDR and CRS in relation to trusts

Both the MDR and DAC6 rules require intermediaries to report to their local tax authorities both past and current arrangements entered into by taxpayers that are either designed to circumvent the application of the CRS or conceal the true beneficial ownership of assets.

These rules require any intermediary (e.g., a lawyer or bank) to disclose information about any arrangement that they have designed, promoted or marketed or where they have been involved in its implementation. If the intermediary is unable to make such a report (e.g., due to legal

professional privilege), the obligation will fall upon the taxpayer. In this way, tax authorities are alerted to particular arrangements entered into by a particular taxpayer but also arrangements that an intermediary may be trying to market more widely to many taxpayers, thus enabling the jurisdiction to adopt legislation to prevent the facilitation of such arrangements.

Sanctions

The imposition of sanctions is a method for jurisdictions to impose extensive restrictions on the individuals or entities that are listed in, or resident in or connected with, a particular jurisdiction.

Obliged entities entering into a new customer agreement are typically advised to analyse sanctions lists to assess whether they can offer their services to the proposed clients as part of their AML risk assessment.

In relation to a trust, for example, a sanctions regime may prevent the advisor or trustee from acting on behalf of a client in setting up a trust. In addition, it may prevent parties from taking certain action in relation to an existing arrangement. For example, the *EU Regulation 2022/576 (as amended)* introduced a prohibition to register, provide a registered office, business or administrative address as well as management services to a trust or any similar legal arrangement where the settlor or a beneficiary is a national or resident of Russia, a legal entity established in Russia, or a legal entity owned by more than 50% or controlled by a Russian individual or legal entity. These sanctions do not apply when the trustor or beneficiary is a national of a Member State or a natural person having a temporary or permanent residence permit in a Member State, in a country member of the European Economic Area, or in Switzerland.

Therefore, in a trust context, a trustee obliged to comply with a given sanctions regime will need to understand:

- the prohibitions imposed by the regime in question;
- whether the regime provides for any licences that would allow conduct that is otherwise prohibited; and
- whether any reporting obligations apply.

Any breaches of the regime can result in criminal prosecution of those involved in the provision of services.

Sanctions are an effective tool used by governments to impose information-gathering obligations on private individuals and entities and to restrict certain business and other interactions that they deem necessary.

Export controls

In addition, the US and other governments have export controls, forbidding transactions, such as on planes that have US engines and aircraft parts. Trust advisors managing planes, yachts and vehicles with US parts must comply with export controls. On 16 February 2023, the Department of Justice (DOJ) and Commerce started the Disruptive Technology Strike Force co-led by the Justice Department's National Security Division (NSD) and Commerce department's Bureau of Industry and Security (BIS). It targets illicit actors, strengthens supply chains and protects critical technological assets from being acquired or used by nation-state adversaries.

On 2 March 2023, the DOJ, BIS and Treasury issued a Joint Compliance Note on 'cracking down on third-party intermediaries used to evade Russia-related sanctions and export controls'. The Compliance Note provides common red flags that can indicate a third-party intermediary may be engaged in efforts to evade sanctions or export controls. Hence, trustees and intermediaries must guard against participating in critical technological assets.

CHALLENGES TO PRACTICAL IMPLEMENTATION OF TAX TRANSPARENCY INITIATIVES

Data protection concerns

The main challenges to FATCA, the CRS, the MDR and DAC6 are data protection concerns.

A great deal of information is required to be disclosed, some of which may have no tax implications in the jurisdiction of residence of the individual disclosed (e.g., disclosure about a discretionary beneficiary who has never received a distribution, or about a protector who cannot benefit from the trust).

The rules are complex and different jurisdictions may have adopted different approaches to their implementation. Where there is a discrepancy between the view taken by a professional advisor, such as a lawyer in one jurisdiction, and another professional advisor, such as a financial institution, in another, this can lead to confusion and wasted time and unnecessary disclosure resulting in investigation into a perfectly legitimate arrangement.

To avoid or minimise this risk, the data held by each jurisdiction needs to be transparent to the individuals and advisors involved, to ensure that the information is correct. Furthermore, it is important to ensure that these initiatives are cost-effective and proportionate as well as having strong guarantees that the information exchanged will be secure and used legitimately by the relevant authorities, rather than as a fishing exercise against individuals.

Whistleblowing: more work needed

Whistleblowing refers to when a person makes a disclosure of information that they reasonably believe shows wrongdoing or someone covering up wrongdoing. We have seen successive and progressive governments that have taken steps to strengthen whistleblowing policy and practice. For example, the EU has recently announced a reinforced whistleblowing mechanism in an AML context. Whistleblowing can be a crucial source of evidence for authorities tackling corruption, fraud and other economic crimes since these activities and their perpetrators can often only be exposed by insiders. However, in some jurisdictions, whistleblowing is still not encouraged, and can result in compromised safety for many who engage in it.

Bribery and corruption

Bribery and corruption represent serious threats to economic growth, individual livelihoods and civil society across the world. For many years, professional bodies like STEP have worked alongside governments, regulators, law enforcement and international bodies/task forces and supported our members to combat bribery, corruption, tax evasion, terrorism and money laundering.

We deplore corruption and the significant harm it causes, and we play a vital role in training, educating and supporting our professions to uphold the highest levels of integrity and ethical standards. We will continue this work and provide support to facilitate national and international cooperation to improve monitoring and enforcement systems.

We also acknowledge the work of reputable institutions such as Transparency International and the Basel Institute on Governance who promote transparency, accountability and integrity in public and private institutions, through the publishing of individual country corruption perceptions, which can be a useful supplement to individuals considering where to do business (see: https://www.transparency.org/en/cpi/2023 and https://baselgovernance.org/basel-aml-index).

HOW EFFECTIVE ARE THESE TAX TRANSPARENCY MEASURES?

FATCA, the CRS, the MDR and DAC6 have been successful in enabling tax authorities to obtain information about beneficial owners of trusts and companies established outside their jurisdiction for the benefit of individuals who are tax resident in their jurisdiction. The tax authorities can then match up this information with the information disclosed in the relevant individual's tax return.

One problem appears to be that information is often provided in such a way that it is difficult for the tax authority to determine the capacity in which it has been provided in relation to a particular beneficial owner. This can result in the tax authority having to follow up with requests for additional information, wasting both the taxpayer's and the tax authority's time and effort.

Over the years, this area has seen significant evolution from a disjointed approach by different national jurisdictions to a more unified and global system with standards set and monitored by the Financial Action Task Force (FATF) and the OECD. These measures have proven effective in STEP's view in encouraging rigorous safeguards helping combat financial crime, including tax evasion. STEP continues to stress that such measures should have appropriate and legitimate boundaries and robust safeguards to ensure the protection of sensitive personal data.

EXISTING INITIATIVES: AML

FATF – The 40 Recommendations

The FATF Recommendations (the first iteration of which was published in 1990; the latest version was released in 2012, though with updates added continuously since then) set out a comprehensive and consistent framework of measures that countries should aim to implement to combat money laundering and terrorist financing, as well as the financing of proliferation of weapons of mass destruction. The Recommendations set an international standard that countries are encouraged to implement through measures adapted to their circumstances.

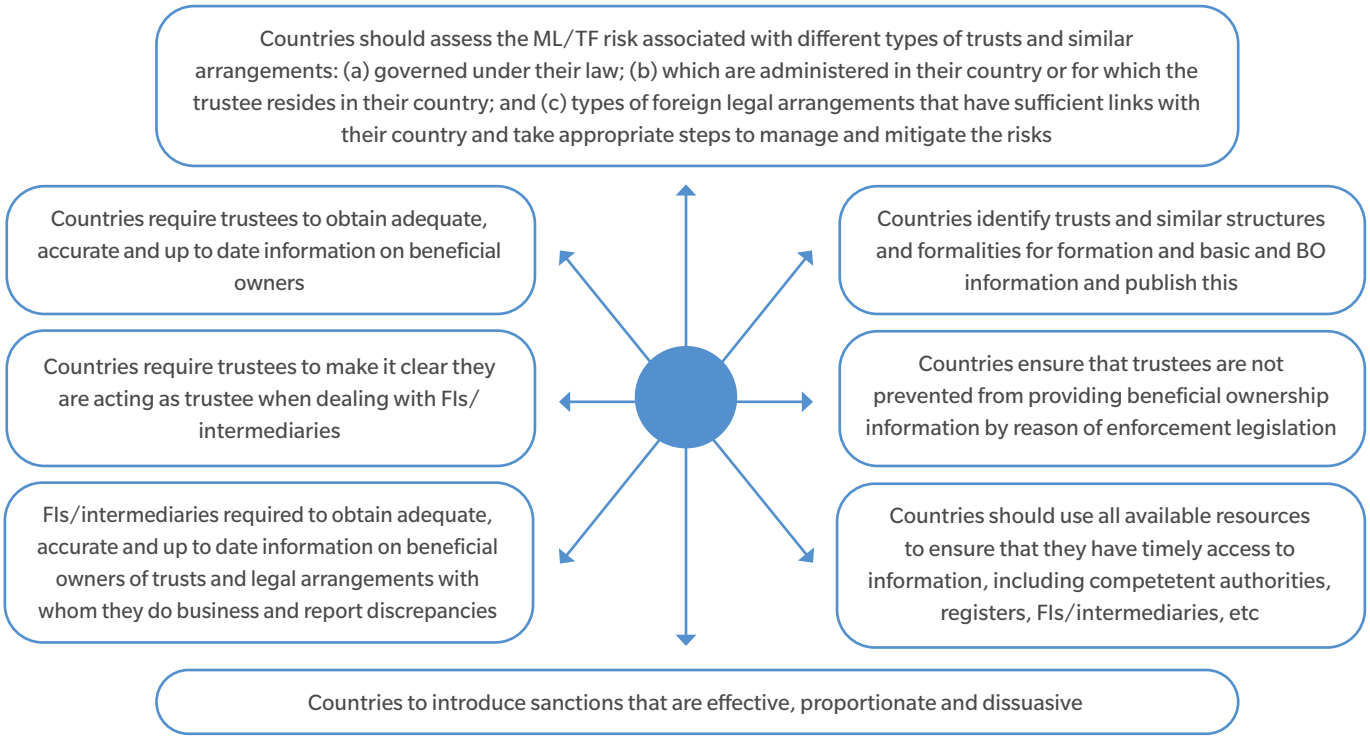
The current version of the Recommendations includes guidance for each country to assess its own compliance with AML standards and assistance with identifying the systems and mechanisms it might need to implement robust international standards.

FATF's risk-based approach guidelines

FATF built on the Recommendations by using a risk-based approach (RBA), which is central to the effective implementation of the Recommendations to fight money laundering and terrorist financing. The RBA allows supervisors, FIs and intermediaries to identify, assess and understand the money laundering/terrorist and proliferation financing (ML/TF/PF) risks to which they are exposed so that they can focus their resources where the risks are highest.

To support the RBA, in 2018 and 2019 FATF produced several guidelines for different sectors, to support the design and implementation of the risk-based approach for the relevant sectors, by providing specific guidance and examples for supervisors, FIs and intermediaries.

Figure 1. FATF multi-pronged approach



In 2023, FATF updated Recommendation 24 (beneficial owners of companies) and Recommendation 25 (beneficial owners of trusts and other legal arrangements). Both Recommendations adopt a multi-pronged approach designed to enable countries to identify and reduce the risk of trusts and other similar arrangements being used in their jurisdiction for the purpose of money laundering, criminal activity or terrorist financing.

EU AML directives

Adopting the approach taken by the FATF, the EU has issued a number of AML directives (AMLDs) aimed at tackling money laundering. The two more recent are 4AMLD and 5AMLD, with 6AMLD currently being prepared with the aim for it to be approved in 2024, together with a proposal intended to ensure a consistent approach is taken to AML across the EU and to improve the sharing of information.

The main changes brought in by 4AMLD were as follows.

- It reinforced rules regarding the identification of beneficial owners of companies and trusts (and other similar legal arrangements).
- It required information on beneficial ownership for companies to be held in each EU country in a central register, such as commercial registers, companies' registers or a public register.
- It brought about a coordinated European policy to deal with non-EU countries that were deemed to have inefficient anti-money laundering, counter-terrorist financing, and counter-proliferation financing (AML/CFT/CPF) regimes to protect the EU financial system, in the form of the first EU list of 'high-risk third countries', which was adopted in July 2016. Rather than adopt the FATF's lists, the EU decided to develop and revise its own, thereby leading to the problem of proliferating lists based on different standards. Small jurisdictions struggle to meet multiple standards, each with different timetables and requirements. Multiple lists, including national and subnational lists and standards, undermine the integrity of the standards.

5AMLD expanded on 4AMLD and one of the main focuses was on the access to national trust registers being limited to competent authorities, firms that are regulated for AML purposes (for customer due diligence purposes), and persons with a 'legitimate interest' in the information. It allowed Member States to retain flexibility to define what 'legitimate interest' means in this context in their own jurisdictions. It also enhanced transparency by setting up publicly available registers for companies, trusts and other legal arrangements.

The new EU arrangements proposed to be introduced in 2024 include rules designed to ensure uniformity of application of AML rules across the EU, the sharing of information and the establishment of an authority for anti-money laundering and countering the financing of terrorism (AMLA).

Beneficial ownership registers

The FATF Recommendations encourage the use of registers of beneficial ownership to record the identities of beneficial owners of arrangements. Such registers have subsequently been adopted in the EU and in many countries. The purpose of a register is to prevent people from being able to hide assets and income that are ill-gotten or on which they owe tax. They are in use in many jurisdictions, are accessible by law enforcement and tax authorities, and, in some cases, are publicly available.

FATF, in its Recommendations, lays the groundwork for jurisdictions in this area. It states that competent authorities should have access to adequate, accurate and timely information on the beneficial ownership and control of legal entities and trusts and other similar legal arrangements.

As an example, England currently has three registers of beneficial ownership. The first, the people of significant control (PSC) register, holds information on the beneficial ownership of companies. The second, the Trust Registration Service, (TRS) specifically holds information on the beneficial owners of trusts. The third, a Register of Overseas Entities, includes

information about the beneficial owners of non-UK entities owning land in the UK.

Although STEP supports the use of beneficial ownership registers, we note the importance of proportionality in making all information contained on such beneficial ownership registers open to the public. It is noted that, in a trust context in particular, a great deal of private information may be disclosed about beneficial owners who may have not added any funds to the structure and may not have any control over, or right to benefit from, the structure. The full public access to such information may leave such beneficial owners open to harm by criminals using the information for illegal purposes.

SARs

A suspicious transaction or activity report (SAR) is a document that FIs and certain other businesses and professions must file with their jurisdiction's financial intelligence unit whenever there is a suspected case of money laundering or fraud. These reports are tools to help monitor any activity within finance-related industries that is deemed out of the ordinary, a precursor of illegal activity or might threaten public safety.

CHALLENGES TO PRACTICAL IMPLEMENTATION OF AML MEASURES

The main challenge that has affected practical implementation of these AML measures is the inherent tension between privacy and transparency. This has played out in the November 2022 European Court of Justice ruling against public beneficial ownership registers in relation to legal entities.

The concern is that public registers make information on those who have limited powers and rights over structures, but who may benefit in the future, open to harm. Threats can include anything from cyberattacks to kidnapping and invidious romantic and platonic relationships. Trusts often protect the interests of vulnerable family members who will be at high risk of abuse of information if their financial status is widely available to the public. In the UK, the PSC register is publicly available on Companies House and the Register of Overseas Entities (RoE) is a public register, but the UK's trust register is a private register, with access granted only to those who can demonstrate a legitimate interest in the information.

Although many beneficial ownership registers allow for applicants to apply for an exemption to the disclosure of certain personal information on the beneficial owner and access to such information, this can only be done in exceptional circumstances. For example, where the applicant can demonstrate that the disclosure of such information would expose that beneficial owner to a disproportionate risk of fraud, kidnapping, blackmail, extortion, harassment, violence or intimidation.

The EU 6AMLD recognises the importance of transparency but notes that: 'While trusts and other legal arrangements can be used in complex corporate structures, their primary objective remains the management of individual wealth. In order to adequately balance the legitimate aim of preventing the use of the financial system for the purposes of money laundering or terrorist financing, which public scrutiny enhances, and the protection of fundamental rights of individuals, in particular the right to privacy and protection of personal data, it is necessary to provide for the demonstration of a legitimate interest in accessing beneficial ownership information of trusts and other legal arrangements.'

The term 'legitimate interest' presents another challenge because it can be interpreted differently from jurisdiction to jurisdiction, meaning some registers could effectively be public and others effectively private. The UK's approach has been to set a high bar for

'legitimate interest', where those wishing to access the register must demonstrate they are investigating a specific case of economic crime and they have reasonable evidence to believe a specific arrangement is being used to facilitate this. Such an approach appears to balance the rights of individuals with effective prevention against economic crime.

The 2022 ruling in the European Court of Justice recognised the role that that journalists and civil society organisations have in the prevention of money laundering and other criminal offences and their legitimate interest in accessing such information on beneficial ownership registers. However, the rules adopted in relation to such access differ widely across jurisdictions (see https://www.transparency.org/en/blog/eu-court-ruling-on-beneficial-ownership-registers-legitimate-access).

HOW EFFECTIVE ARE THESE AML MEASURES?

Effectiveness varies in different jurisdictions as demonstrated by the following:

- 205 countries have committed to implementing the FATF Recommendations and FATF reported[1] in 2022 that: 'In terms of laws and regulations, 76 per cent of countries have now satisfactorily implemented the FATF's 40 Recommendations. This is a significant improvement in technical compliance, which stood at just 36 per cent in 2012'. However, only 53 signed a statement committing to the systematic sharing of beneficial ownership information.
- Although the EU has adopted AML regulations that apply to the whole of the Union, it appears that there has been an inconsistent approach taken across Member States and a relatively slow EU uptake on the adoption of beneficial ownership registers (by May 2021, nine countries had not implemented a beneficial ownership register). The new arrangements proposed to be adopted in 2024 are designed to introduce a common approach and improved sharing of information.

[1] FATF (2022), *Report on the State of Effectiveness Compliance with the FATF Standards*, FATF, Paris, https://www.fatf-gafi.org/en/publications/Fatfgeneral/Effectiveness-compliance-standards.html

HOW THE RULES WORK IN PRACTICE

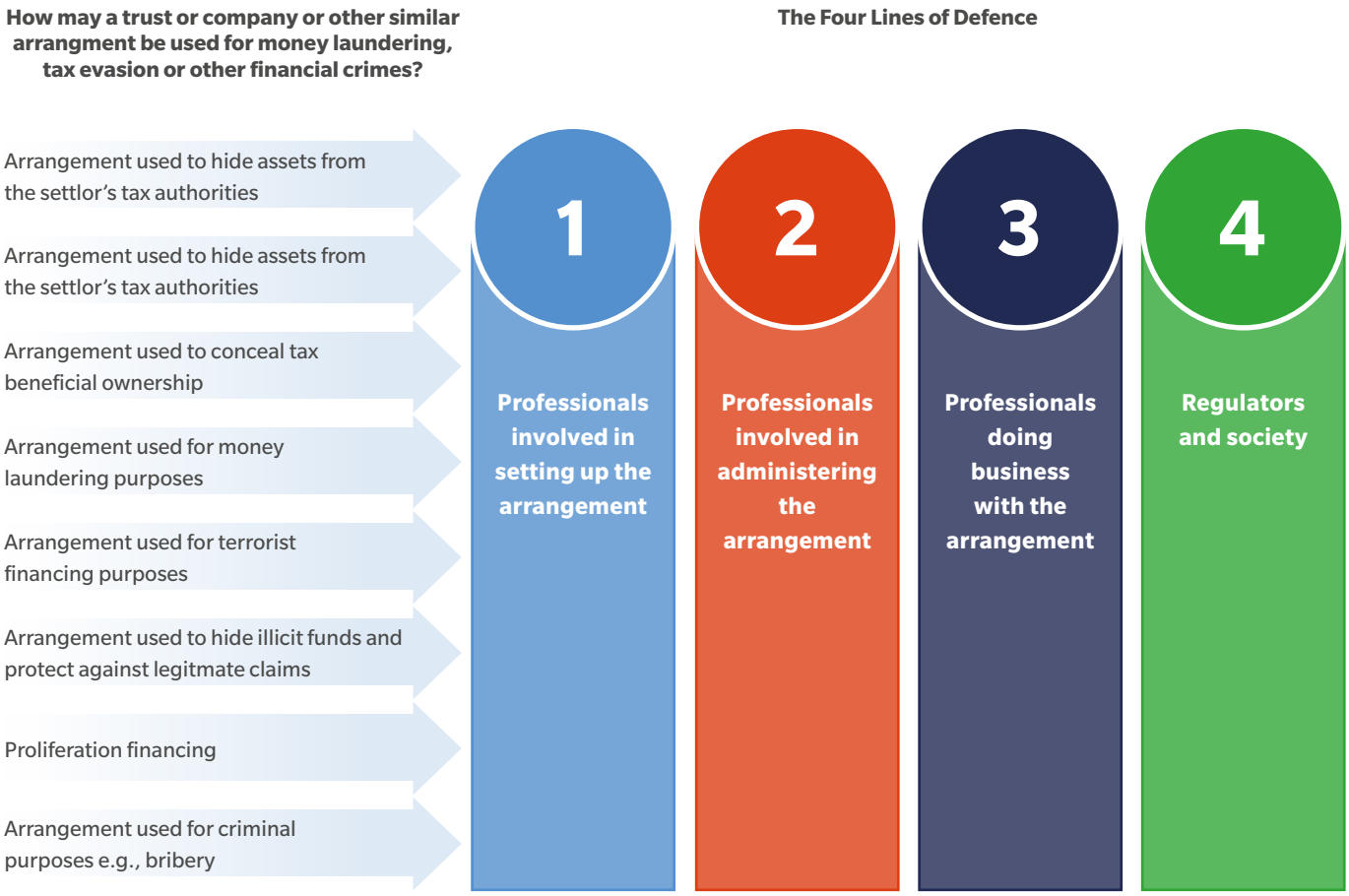
THE FOUR LINES OF DEFENCE

There are several theoretical ways in which a trust or other similar arrangement may be used for money laundering, tax evasion or other financial crimes. All the initiatives described above are designed to prevent such arrangements being put in place or used for these purposes, adopting, as recommended by the FATF, a multi-pronged approach.

The result is four lines of defence against economic crime:

1. First line of defence: those setting up the trust or legal arrangement.
2. Second line of defence: those involved in administering the trust or legal arrangement.
3. Third line of defence: those doing business with the trust or legal arrangement.
4. Fourth line of defence: regulators and society itself.

Below we explain in more detail what happens at each of these stages to provide a clear picture of how these measures work to defend against financial crime.



1. First line of defence – professionals involved in setting up the arrangement

Professional advisors provide multiple layers of defence against such illegal issues. In the first instance, professionals involved in setting up the arrangement are typically under a legal obligation to take reasonable steps on a risk-based approach (see above section on FATF's risk-based approach guidelines) to identify the extent to which the arrangement is to be used for any of these illicit purposes.

AML legislation differs from jurisdiction to jurisdiction and countries place different burdens on those advising on the establishment and administration of a trust. We set out below how a professional dealing with the establishment of a trust may be under an obligation to carry out appropriate AML checks and what steps may be taken to satisfy such obligations.

When taking on a new client, such advisors may be required to identify that the individual is who they say they are. As part of this they will also be required to identify the beneficial owners of the arrangement. This involves seeing an original passport or driving licence, as well as an original utility bill that is no more than three months old.

In some jurisdictions (where the scale of the advisor's operations permits), the client's name and address is then run through a 'compliance check': the client's personal information (including name, date of birth, address and passport number) are checked against information held on open-source data. This search will typically bring up any information about their business activities, including any connections with businesses, information about court judgments and criminal activity, sanctions list, information from the international media, whether the individual is a politically exposed person (PEP) or related to a PEP, and any professional affiliations. Where they are run, such checks are run on all the key individuals involved in the structure. Therefore, if a settlor is setting up a trust for multiple named beneficiaries, these beneficiaries will be subject to these checks

in addition to the settlor. Individual trustees, protectors and other individuals exercising effective control over the trust will also be subject to such checks.

Where a person involved in a trust is an entity (such as a corporate trustee or protector), professional advisors will also be required to carry out AML checks on the entity, including identifying any beneficial owners or controlling persons with respect to this entity. This could include obtaining information that is publicly available, e.g., by checking the corporate register or information held by a regulator and obtaining copies of a Certificate of Incorporation, Articles of Association, Registers of Members and Directors, and original identification documents for the directors. Identification information will also likely be required for any individual beneficial owner or other controlling person of the entity.

In addition to carrying out these practical checks to enable a professional advisor to identify those involved in such an arrangement, the professional advisor may also be under an obligation to obtain more background information. This would typically include information to enable them to understand the purpose for which the arrangement is being set up and administered. If such an arrangement makes little rational or legal sense, this is a clear red flag. In addition, as part of this, the professional advisor may be put under an obligation to obtain information to enable them to understand the tax implications for those involved in the arrangement. If the arrangement is cross-border and appears to either circumvent the CRS, or conceal the beneficial owner, the advisor may need to file a report under the MDR or DAC6.

If the professional advisor is given information that leads them to believe that the arrangement is being used for illegal purposes, the advisor may be under an obligation to make a SAR.

The requirement for entities to be included on a beneficial ownership register also places checks and balances on the formation of a structure. Professional advisors setting up such structures may be under an obligation to obtain information to ensure that they understand any reporting or regulatory obligations associated with the formation and ongoing administration of the arrangement. This can include the requirement to include a trust on a trust register, or to register the beneficial owners of a company on a corporate or beneficial ownership register. The failure to make such a filing or update a register may prevent a transaction from going ahead. Those involved in updating the register are also typically under an obligation to verify the information contained or to be included on the register and to report any discrepancies to the relevant authorities.

Therefore, AML legislation in many jurisdictions has been designed to ensure that there are multiple obstacles and checks in the way of setting up such entities and arrangements for illegal purposes. However, this is only the first layer of defence against such criminal activity.

It is possible that the arrangement was set up some years ago, before the introduction of AML rules, or circumstances have changed such that the arrangement is no longer being used for wholly legitimate purposes. In this case, there may be a second line of defence where obligations are imposed on those administering the structure.

2. Second line of defence – professionals involved in administering the arrangement

The second layer involves professionals who are involved in administering the arrangement. If, for example, in the rare circumstance where an arrangement for illegal purposes is set up, or a previously legitimate arrangement is turned to illegitimate purposes, professional advisors may be under obligations to review the structure and report information.

Many jurisdictions require professional advisors involved in administering a trust arrangement to carry out ongoing AML obligations, requiring them to update their AML information on a regular basis.

In such a case, where there is a change in the structure itself, e.g., the addition or removal of a beneficiary, the professional trustee will be obliged to identify the new beneficiary and understand the reasons for the change proposed.

In addition, such advisors taking on new clients must identify the beneficial owners of any arrangements and must regularly review this information. Following FATF guidance, each client would be assessed on a risk-based approach, so higher-risk clients are reviewed annually. Based on FATF guidance, they are those with:

- cross-border arrangements
- cash intensive businesses
- links to FATF-high-risk jurisdictions
- very complex structures
- structures involving PEPs, and
- links to oil/mining industries.

Under FATF guidance, clients who are considered a low risk, for example, simple family structures where the beneficial owners are only tax-resident in one country, are reviewed at least every two years and when new instructions are given.

FATF guidance provides that low-risk clients, such as publicly owned enterprises or companies registered on a regulated market, need to be reviewed less often, perhaps at least every three years.

Again, professionals acting under such AML obligations are typically required to take steps to ensure that they understand the purpose of the arrangement and any tax implications for the arrangement and beneficial owners. As part of this, they must also understand any reporting or regulatory obligations associated with the arrangement. Professional advisors may be required to have systems in place to ensure compliance with tax, reporting and regulatory obligations for the arrangement to which they are providing services. They may also be under an express obligation to report any suspicion of criminal activity associated with the arrangement.

Advisors may also be required to obtain information as to what is contained in beneficial ownership registers (including those that are not available to the public) when taking on a new business to ensure that the trust or entity to which they are providing services is compliant with its obligations. The advisor is also likely to be under an obligation to report any discrepancy between the information disclosed on the register and the information that the professional advisor obtains as part of their ongoing AML obligations.

A professional trustee may also be under an obligation to make annual reports under FATCA and the CRS to the extent that these apply to the structure. Where such reporting obligations arise, they will need to have carried out appropriate investigations to ensure that they can identify all the beneficial owners and their jurisdictions of tax residence to enable them to make an appropriate report.

If the arrangement appears to be designed to circumvent the application of the CRS or conceal the beneficial owner, the advisor may be under an obligation to make a report under the MDR or DAC6. It is not only professional advisors involved in setting up and administering the structure who may be subject to appropriate AML obligations. Those entering a business relationship with the trust or similar arrangement may also be subject to their own AML obligations and represent a third line of defence.

3. Third line of defence – professionals doing business with the arrangement

In practice, it is difficult for a trust or other legal arrangement not to encounter another third party with whom it wants to do business, e.g., a lawyer to advise on the purchase of an asset, an accountant to prepare tax filings or a bank to open an account. All these advisors may also be under their own AML obligations to ensure that they know with whom they are doing business.

Where present, these obligations typically require the professional to identify the beneficial owners of the trust or other legal arrangement. Their AML obligations may be lower than the obligations imposed on those administering the trust or legal arrangement: they may be under an obligation to carry out appropriate AML checks on the beneficial owners but typically do not have to obtain information to understand the purpose for which the trust has been established.

Depending on the services being provided to the trust, the third-party professional (e.g., a bank) may also be under an obligation to make a report under FATCA or the CRS with respect to the trust. In this case, the professional will be under an obligation to identify and verify the identity of all beneficial owners or controlling persons of the trust.

The third-party professional may be obliged to make a report if they are involved in an arrangement that is designed to circumvent the CRS or otherwise obscure beneficial ownership under the MDR, or an arrangement that falls within the other hallmarks of DAC6. But depending on the services being provided, such a professional may not be under an obligation to investigate whether any such arrangement would satisfy the hallmarks of the MDR or DAC6.

As with other professional advisors, professionals providing services to the trust or an underlying entity (e.g., providing banking services) may be also be under an obligation to:

- verify information contained in beneficial ownership registers and report any discrepancy; or

- make a SAR if they receive information that causes them to suspect that the arrangement is being used for a criminal purpose.

The roles of these professionals are, however, of key importance where others involved in the arrangement are persons who are not acting in the course of a business. For example, individual lay trustees or lay individuals owning and managing a company. Although the current FATF Recommendations 24 and 25 are also considering the extent to which non-professional trustees and directors are required to comply with appropriate AML regulations, it is difficult to impose such obligations on lay persons.

The fourth line of defence in the fight against AML and the use of trusts for criminal activities is society itself.

4. Fourth line of defence – regulators and society

Tax authorities and regulators in jurisdictions who have adopted AEOI agreements receive a great deal of information about offshore structures, the CRS and FATCA, SARs, beneficial ownership registers, professionals subject to AML rules and information exchange with regulatory tax authorities within the jurisdiction and elsewhere.

Increasingly in many jurisdictions we are seeing a burden being placed upon professionals to report information about arrangements with whom they do business, including SARs, reports under MDRs and requirements to report discrepancies in beneficial ownership registers to tax and other authorities in their jurisdiction.

The FATF guidance on Recommendations 24 and 25 encourages the sharing of such information between different countries and removing blocks that prevent the sharing of such information.

However, it is acknowledged that the tax authorities and regulators find this obligation challenging, due to financial and other constraints, in carrying out these obligations solely by themselves.

As noted above, the 2022 ruling in the European Court of Justice recognised the role that that journalists and civil society organisations have in the prevention of money laundering and other criminal offences and their legitimate interest in accessing such information on beneficial ownership registers to enable them to carry out such investigations.

SOLUTIONS

WHAT ARE THE KEY PROBLEMS AND SOLUTIONS?

The above sections demonstrate both the range of measures currently in place to tackle economic crime and the way in which these measures work in practice.

The initiatives thus far have led to a huge amount of information being reported globally. This has the potential to be highly effective in identifying and deterring financial crime.

We believe the issue now is more about how that information is being collected and managed, the quality of the information and what is being done with that information, which varies from one jurisdiction to another. This is where we can see gaps and inconsistencies which, if not addressed in a joined-up way, can render all this effort moot.

We therefore believe the next phase of work to tackle financial crime needs to be in reviewing the policies, processes and standards to harmonise these and make them more effective and efficient. This will close up gaps that may be exploited by criminals and will also ensure we have a more workable system in the global context, rather than the existing patchwork of overlapping and differing obligations.

In light of this, below we detail six issues that we believe are obfuscating the fight against financial crime. We propose solutions for these specific issues and outline the positive impact that the recommendations could have on the efficacy of the system.

As a general point, we also believe that more research should be undertaken on the costs and outcomes of tackling financial crime under the current system. The private sector has borne much of the load, both in terms of guarding the perimeter of legitimate business enterprise and carrying the burden of the costs, which are likely to run into many tens if not hundreds of billions of dollars annually. It is important to ensure that the current system, and any new policies proposed in this area, are cost effective in achieving their aims.

1. Poor quality SARs wasting time and resource and impacting effectiveness

What is the problem?

SARs are a vital source of intelligence in relation to economic crime and should be fully utilised where possible. However, we are advised by our members based in jurisdictions where SARs are required that a significant percentage of SARs that are filed by banks, FIs and legal professionals are not processed for a variety of reasons:

- There is no detailed guidance or advice available for an applicant therefore the SAR is often returned to the applicant saying that it is an unacceptable submission and the case is closed.
- Applicants can spend a significant amount of time correcting the SAR when it is returned multiple times, to make it acceptable, which is clogging up the system.
- Applicants are unsure whether they need to submit a SAR, so they rush to submit one if they are uncertain about the circumstances, to avoid any serious repercussions.
- There is currently no cohesive international standard, so the SARs process and requirements vary from one country to another. There may also be a different process for banks when submitting SARs.

Continued on next page

What is the solution?

- Many of our members have suggested that it would be helpful in their jurisdictions to have more prescriptive guidance and increased awareness around what to report. Examples of good and bad SARs would be helpful for applicants, alongside FAQs.
- As a practical matter, it is suggested that standardisation of the information and an automated portal that could potentially include utilisation of artificial intelligence for the initial screening SARs could assist in the submission and review of information contained in SARs.
- Our members who are involved in cross-border work also advise that the development of an international standard to ensure global consistency would assist in ensuring that the provision of information contained in SARS could be used most efficiently.

What impact would this have?

For governments

- Better quality reporting will free up government resources and reduce the volume of applications to just those that are required, which would help to ensure they all are processed.
- A standardised, mainly automated process would reduce reliance on human resources and flag issues more effectively. Ultimately, this would lead to greater effectiveness in addressing crime. A standardised and mainly automated process would facilitate sharing information by financial intelligence units and law enforcement.

For individuals/entities/businesses

- More prescriptive guidance would help to provide greater certainty and reduce wasted time submitting unnecessary reports or dealing with rejected ones.
- An international standard would harmonise and simplify requirements for those operating in multiple jurisdictions.

2. Compliance duplication and volume of reports

What is the problem?

Our members report that the trust industry has become dominated by compliance checks and due diligence, which is driving up costs for customers, increasing the burden on practitioners and regulators, and resulting in a huge duplication of effort and resource.

What is the solution?

Introduce an AML 'compliance passport' or digital identity. Effectively, this proposal is to create a cooperative compliance programme. Participants in this programme would undergo a review by AML authorities to determine their compliance with tax obligations, money laundering and sanctions concerns. Successful participants would receive a 'compliance passport', which they could present to FIs, authorities and other parties to demonstrate compliance across jurisdictions. The EU is taking steps to adopt such an approach with the Europe digital identity programme (see *Regulation of the European Parliament and of the Council amending Regulation (EU) No 910/2014* as regards establishing the European Digital Identity Framework). The suggested process would involve:

1. Selection: participants initiate the process with a lead tax administration in their jurisdiction or where the majority of assets are located.
2. Compliance review: participants provide information and undergo reviews by AML authorities or third-party assessors.
3. Issuance of compliance passport: a compliance passport is issued if the participant is found compliant.
4. Periodic review: compliance status is periodically reviewed and renewed.

What impact would this have?

For governments

- A compliance passport would reduce distortions in the transparency regime and enhance the certainty of an individual's AML compliance.

For individuals/entities/businesses

- Compliance passport holders would receive faster service e.g., opening bank accounts, which can take several weeks, if not months, depending upon the jurisdiction.
- The compliance passport would provide legal certainty, consequently reducing the risk of investigations and disputes for compliance passport holders.
- Compliance passport holders will reduce compliance costs for businesses due to the simplified due-diligence process.
- Compliance passports may help prevent identify fraud or the criminal use of beneficial ownership information.

3. Lack of verification of beneficial ownership information

What is the problem?

In many countries, there is no verification of the beneficial ownership data that is submitted to company and trust registers (where they exist) and, due to the absence of validation, the information being stored may have very little practical use in the fight against money laundering and other illegal activities. If the information is not verified then it is virtually useless and the register is ineffectual. Consequently, the fear is that information held on the beneficial ownership of legal arrangements and trusts may be inaccurate, inadequate and out of date. Registers without verification are significantly weakened and open to abuse.

What is the solution?

Where such company and trust registers are in place, an obliged entity should be responsible for verifying the information about that company or trust that is submitted. We note that the OECD, FATF and Transparency International have recognised efforts taken in jurisdictions, including, for example, the Central Register of Beneficial Owners (CRBO) implemented in Spain, although it is recognised that further work needs to be done generally to make such registers effective both in terms of accurately identifying beneficial owners and improving administrative efficiency. We note by way of example that the CRBO is obligated to verify and provide information relating to Spanish legal entities and trust structures and its implementation is considered a positive step towards Spain's improved standing against international compliance standards. The CRBO requires relevant entities to provide data to it for verification every nine months, with non-compliance resulting in the closure of registration. Furthermore, the CRBO is connected to the central European platform, allowing for ease of data sharing between other EU Member States.

We recommend that there is clear guidance on what information is required to be disclosed on such registers, particularly in relation to registers where information about a trust structure is required to be disclosed. In considering the information to be disclosed, we recommend that careful thought is given to balancing the requirement to provide information about beneficial owners and any rights to privacy afforded to such beneficial owners.

What impact would this have?

For governments

- Better-quality data will enable governments to tackle financial crime more efficiently. Verified beneficial ownership registers will make it significantly harder for such individuals to conceal their identities behind complex corporate or trust structures.

For individuals/entities/businesses

- Verification will provide reassurance and certainty that information is accurate and will mitigate any liability for mistake or criminal sanctions.

4. Some structures have no defined beneficial owner

What is the problem?

There are some entities that reasonably believe that they do not have any registrable beneficial owners. While the reason for not registering may be legitimate, this provision creates a lacuna that could be taken advantage of by those seeking to hide the ultimate beneficial ownership. Our members report that there are some trust arrangements, put in place for wholly legitimate purposes, where there is no identifiable beneficial owner.

What is the solution?

Require entities without a registrable beneficial owner to provide a fuller explanation to the relevant registrar as to why this is the case. This would be assisted by clear guidance about the definition of ownership and control, which (as noted above) would also improve the quality of information to be included in such a register.

We suggest that information about each 'managing officer' of the entity should also be provided.

What impact would this have?

For governments

- It will provide governments with greater certainty and understanding so they do not waste resources on investigating cases that have legitimate reasons for making such a claim.

For individuals/entities/businesses

- There will be less suspicion of arrangements that have not registered and a greater clarity and understanding for the reasons why they have not.

5. Whistleblowing is not encouraged in some jurisdictions

What is the problem?

Whistleblowing refers to when a worker makes a disclosure of information that they reasonably believe shows wrongdoing or someone covering up wrongdoing. We have seen successive and progressive governments that have taken steps to strengthen whistleblowing policy and practice. It is a crucial source of evidence for authorities tackling corruption, fraud and other economic crimes since these activities and their perpetrators can only be exposed by insiders. It also provides a route for employees to report unsafe working conditions and wrongdoing across all sectors. However, in some jurisdiction's whistleblowing is still not encouraged, resulting in compromised safety and potential criminal prosecution for many who engage in it.

What is the solution?

Offending jurisdictions to review and strengthen their frameworks for whistleblowing.

What impact would this have?

For governments

- More people will come forward, providing a crucial source of evidence for authorities tackling corruption, fraud and other economic crimes.
- Better participation in global compliance, fostering better relationships with jurisdictions that already have sufficient beneficial ownership registers in place.
- Enabling a level-playing field, encouraging new investment, and improving cross-border relationships.

For individuals/entities/businesses

- Enhanced reputation through adherence to legitimate compliance and reporting measures.

6. Varying and multiple standards and inconsistent application of them

What is the problem?

While many jurisdictions have adopted FATF's recommendations and standards and been reviewed and rated accordingly, there are some notable exceptions. This leaves the systems in those jurisdictions exposed to significant criminal risks and can undermine global efforts to tackle economic crime. It also creates an uneven playing field for businesses across these jurisdictions.

In addition, some countries and regions have decided to devise their own lists and standards for rating countries' AML and tax practices, rather than adopt the FATF's lists of 'high-risk jurisdictions'. This has led to the problem of proliferating lists based on different standards. Small jurisdictions struggle to meet multiple standards, each with different timetables and requirements. Ultimately, multiple lists, including national and subnational lists and standards, undermine the integrity of the standards.

What is the solution?

All countries to agree to one 'global standard', with clear requirements around the process and criteria for placing a country on a caution list, as well as how they can be taken off.

All jurisdictions should be held to the same standards in order to effectively tackle financial crime. International financial regulation must proceed on the basis of non-discrimination and a level playing field.

What impact would this have?

For governments

- Clarity and consistency for governments on measures that need to be taken to meet required standards.
- All jurisdictions on an equal footing – reducing possibility of jurisdiction shopping based on lower compliance costs, etc.

For individuals/entities/businesses

- Greater clarity for clients and businesses on where to base their operations.


STEP
ADVISING FAMILIES ACROSS GENERATIONS