

THE LEGAL ENTITY IDENTIFIER: TOWARDS IMPROVED CORPORATE TRANSPARENCY

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Abstract

In the aftermath of a succession of data leaks, insufficient accuracy and accessibility of basic and beneficial identification and ownership information have been identified as an enabler of illicit financial flows. As a result, many have called for greater transparency around corporate data. The purpose of this chapter is to present the current transparency initiatives that are aimed at improving access to this data. Different registers have been proposed, not only internationally but also in many domestic fora. These should help counter the use of corporate vehicles for illicit purposes. They are expected to address especially money laundering, bribery and corruption. In this chapter, three new initiatives are discussed: the European Union (EU) register as implemented under the 4th AML Directive; the UK register of beneficial owners; and the Global Legal Entity Identifier (LEI) system. The primary issue is how ready these instruments are to be put into effective operation. This chapter analyses their pros and cons, as well as a number of challenges that regulators will have to face.

1 Why are these transparency initiatives important?

Illicit financial flows thrive on secrecy.¹ Shell companies, complex ownership and control structures, trusts and other legal arrangements are commonly used to obscure the true beneficial ownership of assets.² These

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1 Report of the High Level Panel on Illicit Financial Flows from Africa commissioned by the AU/ECA Conference of Ministers of Finance, Planning and Economic Development, http://www.uneca.org/sites/default/files/publications/iff_main_report_26feb_en.pdf, 42 (accessed 01 September 2016).

2 The classical example of the role corporate vehicles might play in transactions involving illicit financial flows is the *Abacha* case. Sani Abacha was Nigeria's former President and is estimated to have stolen up to USD5 billion during his rule from 1993 to 1998. Part of the money was held in trusts in Guernsey which had bank accounts in London, secret bank accounts in Europe, and shell companies in British Crown Dependencies. Source: OECD *Report on the Misuse of Corporate Vehicles for Illicit Purposes* 2001 92.

are not only channels for money laundering, tax avoidance and tax evasion, but are also used to hide the proceeds of corruption. Not many jurisdictions collect information about beneficial ownership at the time a company is set up. This makes international cooperation more difficult.³ Not surprisingly, substandard beneficial ownership requirements are perceived as a dangerous legal deficiency which must be addressed.

Considering this, many international bodies have urged governments to take specific actions to enhance the transparency of corporate vehicles. The G8 Leaders were the first to demand action against corporate secrecy. In Lough Erne in 2013, the G8 Leaders recognised data as a key instrument to assist government effectiveness, efficiency and responsiveness to citizens, whereas the lack of transparency was perceived as an important obstacle to sustainable development.⁴ The Leaders formulated eight 'Action Plan Principles' to prevent the misuse of companies and legal arrangements. In their Communiqué, first, they indicated that companies, as well as trustees of express trusts, should retain adequate, accurate and current information on who owns and controls them and their beneficial ownership. Second, law enforcement, tax administrations and other relevant authorities, including, as appropriate, financial intelligence units, should be provided with access to beneficial ownership information on companies and trusts. Additionally, they requested that domestic agencies work together effectively. The cooperation should take place not only at the domestic but also the international level. These operations should address illicit activities stemming from the abuse of companies and legal arrangements.

In response to existing loopholes in legal frameworks, the Financial Action Task Force (FATF) also initiated significant steps to improve the transparency of corporate data. Considering the abuse of legal persons and arrangements for the purpose of illicit activities, the FATF added standards on transparency of beneficial ownership information concerning corporates and legal arrangements to its Forty Recommendations and Interpretative Notes (FATF Recommendations).⁵ Currently, the body requires countries to ensure that tax administrations can access adequate, accurate and timely information regarding the beneficial ownership of corporate vehicles and legal arrangements. The recommendations by FATF which incorporate these principles were endorsed by the G20.⁶

3 OECD *Illicit Financial Flows from Developing Countries: Measuring OECD response* 2014 41.

4 G8 Leaders' Communiqué, Lough Erne, 18 June 2013.

5 FATF Recommendations 24 and 25.

6 G20 Leaders' Declaration, St Petersburg Summit, 6 September 2013, and the G20 Communiqué from the Meeting of G20 Finance Ministers and Central Bank Governors, Moscow, 19-20 July 2013, G20 High-Level Principles on Beneficial Ownership Transparency 17 November 2014.

The request to improve transparency of corporate data elicited direct responses from national governments as well. A number of countries committed to establish public registries of corporate ownership information (for example, Denmark, the United Kingdom and Norway). The EU also took significant steps by proposing domestic public registers under the new 4th Anti-Money Laundering Directive.⁷

At the same time, the transparency of corporate vehicles was also recognised as beneficial for financial stability in the wake of the financial crisis. This was why the legal entity identifier (LEI) was introduced. This should improve the measurement and monitoring of systemic risk. The LEI is a unique and exclusive identification code based on basic data regarding an entity that is held in a register. The vision is that the LEI will obtain global reach and enable the worldwide recognition of transaction parties.

The existence of several parallel initiatives to improve transparency does raise some questions. Will these initiatives satisfy the relatively high standards of adequate, accurate and current information that are necessary to support the efforts to curb illicit financial flows? The purpose of this chapter is to examine three of these initiatives (the UK register; the 4th AML Directive registers; and the LEI) to identify challenges that regulators could face when implementing them. All these instruments have the potential to curb illicit financial flows by improving transparency.

2 The misuse of legal persons and arrangements and the FATF recommendations

The FATF⁸ recognised the need to tackle the misuse of legal persons and arrangements to facilitate illicit activities and added to its Forty Recommendations and Interpretative Notes (FATF Recommendations).⁹ Although the FATF standards for transparency of beneficial ownership

7 Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC. JO L/2015/141/73 (4th AML Directive).

8 The FATF is an inter-governmental body. It was established in 1989 by the Ministers of its member jurisdictions. The FATF is currently seen as the main standard-setting organisation in the field of legal, regulatory, and operational measures for combating money laundering, terrorist financing, and other related threats to the integrity of the international financial system.

9 FATF International Standards of Combating Money Laundering, and the Financing of Terrorism and Proliferation, the FATF Recommendation, February 2012. The FATF Recommendations do not constitute a legally-binding instrument under international law. However, they have been globally recognised and, therefore, can be considered to be soft international law. In order to comply with the FATF Recommendations, countries are expected to implement them in their national legal

information were designed to prevent misuses of corporate vehicles for money laundering or terrorist financing, they also support the efforts to prevent and detect other illicit activities, such as tax crimes and corruption.

FATF Recommendation 24 establishes standards on transparency in respect of legal persons. The standard states the following:

Countries should take measures to prevent the misuse of legal persons for money laundering or terrorist financing. Countries should ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities. In particular, countries that have legal persons that are able to issue bearer shares or bearer share warrants, or which allow nominee shareholders or nominee directors, should take effective measures to ensure that they are not misused for money laundering or terrorist financing. Countries should consider measures to facilitate access to beneficial ownership and control information by financial institutions and DNFBPs¹⁰ undertaking the requirements set out in Recommendations 10 and 22.

The interpretative note to Recommendation 24¹¹ explains that the subjective scope of the standard refers not only to legal persons but also to foundations, Anstalt, and limited liability partnerships. Recommendation 24 also clarifies the minimum basic information that should be obtained

systems in compliance with a regular procedure established in their constitutional laws. The enforcement of the FATF Standard is ensured by on-site visits and off-site reviews of the documentation provided by reviewees. The mutual evaluations are being conducted by the assessors who are appointed by FATF itself, the Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (Moneyval), the Asia/Pacific Group on Money Laundering (APG), and the other FATF-like regional bodies.

- 10 Under the FATF Recommendations, the term 'designated non-financial businesses and professions' is defined with an exhaustive list of subject persons that are expected to have an increased probability to be exposed to the proceeds of crime in their regular professional activity or business: (i) casinos; (ii) real estate agents; (iii) dealers in precious metals; (iv) dealers in precious stones; (v) lawyers, notaries, other independent legal professionals, and accountants – this refers to sole practitioners, partners, or employed professionals in professional firms; it does not refer to 'internal' professionals who are employees of other types of businesses nor to professionals working for government agencies who may already be subject to AML/CFT measures; (vi) trust and company service providers refers to all persons or businesses that are not covered elsewhere under these Recommendations and which, as a business, provide any of the following services to third parties: (a) acting as a formation agent of legal persons; (b) acting as (or arranging for another person to act as) a director or secretary of a company, a partner of a partnership, or a similar position in relationship to other legal persons; (c) providing a registered office; business address or accommodation, correspondence or administrative address for a company, a partnership or any other legal person or arrangement; (d) acting (or arranging for another person to act) as a trustee of an express trust or performing the equivalent function for another form of legal arrangement; (e) acting (or arranging for another person to act) as a nominee shareholder for another person. Further, it should be noted that designated non-financial businesses and professions have been included in the FATF Recommendations in 2003. The FATF Recommendations 2003 are available online at <http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202003.pdf> (accessed 10 September 2017).

- 11 FATF Recommendations 2012 84.

and recorded, which includes (a) company name; proof of incorporation; legal form and status; the address of the registered office; basic regulating powers (for example, memorandum and articles of association); a list of directors; and (b) a register of its shareholders or members containing the names of the shareholders and members as well as the number of shares held by each shareholder and categories of shares (including the nature of the associated voting rights).

FATF Recommendation 25 refers to the transparency of legal arrangements and reads as follows:

Countries should take measures to prevent the misuse of legal arrangements for money laundering or terrorist financing. In particular, countries should ensure that there is adequate, accurate and timely information on express trusts, including information on the settlor, trustee and beneficiaries that can be obtained or accessed in a timely fashion by competent authorities. Countries should consider measures to facilitate access to beneficial ownership and control information by financial institutions and DNFBPs undertaking the requirements set out in Recommendations 10 and 22.

The interpretative note to Recommendation 25¹² indicates that the standard refers to both trusts and other types of legal arrangements that may have a similar structure or function. The minimum scope of information which should be recorded encompasses the identity of the settlor; the trustee(s); the protector (if any); the beneficiaries or class of beneficiaries; and any other natural person exercising ultimate effective control over the trust and information on other regulated agents of and service providers to the trust, including investment advisors or managers, accountants and tax advisors.

Both Recommendations recognise the necessity of international cooperation on exchange of beneficial ownership information between competent authorities. Therefore, the standards recommend easing and smoothing the access to basic information that is held by registries for foreign competent authorities. They also call for exchanging information between foreign competent authorities. Finally, they encourage the making use of powers to obtain beneficial ownership information prescribed in domestic law. This may be the way to help a foreign counterpart in accessing beneficial ownership information.

Thus far, the implementation of the FATF standards on transparency of beneficial ownership information has not been that simple, as evidenced by the FATF Guidance on Transparency and Beneficial Ownership (Recommendations 24 & 25) issued in 2014, aimed at assisting countries in the implementation of Recommendations 24 and 25. Moreover, the last OECD report measuring responses of the OECD countries to illicit

12 FATF Recommendations 2012 89.

financial flows¹³ revealed that compliance with Recommendations 24 and 25 was substandard. Regarding all FATF Recommendations, average OECD country compliance is the lowest for transparency of legal persons and arrangements.¹⁴ The report indicates that several OECD countries do not require beneficial ownership information on all types of legal structures and particularly not in respect of trusts.¹⁵

Nonetheless, the G20 has endorsed the FATF standards on transparency of beneficial ownership and encouraged countries to address the risks raised by the opacity of corporate vehicles. In their 2013 public declaration they stated:¹⁶

We commit to take measures to ensure that we meet the FATF standards regarding the identification of the beneficial owners of companies and other legal arrangements such as trusts that are also relevant for tax purposes. We will ensure that this information is available in a timely fashion to law enforcement, tax collection agencies, and other relevant authorities in accordance with the confidentiality legal requirements, for example, through central registries or other appropriate mechanisms. We ask our Finance Ministers to update us by our next meeting on the steps taken to meet FATF standards regarding the beneficial ownership of companies and other legal arrangements such as trusts by G20 countries leading by example.

3 New European Union legislation on corporate ownership information

The move to beneficial ownership registers has been quickened by the European Union. The 4th AML Directive imposed an obligation on member states to store beneficial ownership information a central register, aligning its policy with FATF Recommendations. The new directive must be transposed into national laws by the member states within two years from 26 June 2015.

The basic concept for the analysed obligation is that of the 'beneficial owner' which, according to the 4th AML Directive, is 'any natural person who ultimately owns or controls the customer and/or the natural person(s) on whose behalf a transaction or activity is being conducted'.¹⁷ The directive also specifies how to identify beneficial ownership in the cases of corporate entities, trusts and other legal entities such as foundations.¹⁸

13 OECD (n 3 above).

14 OECD 27.

15 OECD 35.

16 G 20 Leader's Declaration, St Petersburg Summit, 6 September 2013.

17 Art 3 para 6 of the 4th AML Directive.

18 Art 3 paras 6(a), (b) and (c) of the 4th AML Directive.

The 4th AML Directive obliged member states to establish two types of beneficial ownership registers, including one for corporate and legal entities and another for trusts. For this purpose, member states can use a central database that already is in place, provided that it collects beneficial ownership information, business registers, or any other central registers. It is worth noting that neither form of these registers is relevant to foundations that are not legal persons.

As for registers of corporate and legal entities, the information they contain shall be accessible to competent authorities and FIUs in all cases without any restriction; to obliged entities within the framework of customer due diligence in accordance with the 4th AML Directive; and to any person or organisation that can demonstrate a legitimate interest for acquiring the information. Certain limitations to access is permitted on a 'case-by-case basis in exceptional circumstances where such access would expose the beneficial owner to the risk of fraud, kidnapping, blackmail, violence, or intimidation or where the beneficial owner is a minor or otherwise incapable'.¹⁹ Member states are also allowed to ensure the protection of personal data that is included in the registers.

A separate register is provided for trusts. The 4th AML Directive differentiates obligations imposed between trusts governed by the law of a member state, trustees in general, and trusts that generate tax consequences.²⁰ The first type of entity is required only to store data but not to report it anywhere. The second type must disclose its status and provide basic information in the event that they form a business relationship or perform an occasional transaction above the thresholds stipulated in the 4th AML Directive. Only the last type, trusts that generate tax consequences, is required to provide certain data to a central register. This apparent loophole in the new European Union legislation is discussed below.

Access to the data held in the trusts register is restricted by comparison to the register for corporate and legal entities. Only competent authorities and financial intelligence units are granted timely and unrestricted access. Timely access may be also granted to obliged entities within the framework of customer due diligence in accordance with the 4th AML Directive.²¹

The 4th AML Directive will increase the transparency of company ownership. It should also enhance control to both regulatory and criminal enforcement agencies in the European Union. Registers that member states have been required to introduce should reduce illicit financial flows, particularly money laundering. They are expected to help identify potential misconduct and those businesses that are either intentionally, or

19 Art 30 para 9 of the 4th AML Directive.

20 Art 31 para 4 of the 4th AML Directive.

21 Art 31 para 4 of the 4th AML Directive.

unintentionally involved in illicit activity. This will be possible because the central registers will enable different enforcement agencies to access a broad scope of information to conduct due diligence. Masking money laundering transactions and other illicit financial flows will be much more difficult, as the registers listing information about the ultimate beneficial ownership of the parties to financial transactions will enable greater transparency in these transactions.

Nevertheless, some important issues still need to be addressed.

First and foremost, the new directive proposes registers but only at the national level. As most illicit financial flows involve cross-border transactions, it will be necessary to access data held in the registers of other countries to piece together a complete picture of a transaction. Consequently, the exchange of information between competent authorities and FIUs from different member states will be essential. To address this issue, the 4th AML Directive suggests that member states use the system of interconnection of central registers established via the European central platform established by article 4(a)(1) of Directive 2009/101/EC. At this time it is difficult to assess whether it will be sufficient to address the needs of competent authorities. The 4th AML Directive obliged the Commission to provide a report on the conditions and the technical specifications and procedures for ensuring safe and efficient interconnection of the central registers by 26 June 2019. This allows two years for testing how beneficial owner register will function in practice.

In addition, so far the 4th AML Directive is very limited in terms of who gains access to data stored in registers and the purposes for which the information may be used. It does not grant unrestricted access to tax authorities, asset recovery offices, other law enforcement services and anti-corruption authorities. Information cannot be accessed for the purposes of law enforcement investigations, including asset recovery and tax offences. The Commission is, however, considering whether to change that in the future.²²

There are also doubts concerning the protection of personal data under the 4th AML Directive. The Directive attempts to strike a balance between addressing the risks of money laundering and the protection of each individual's personal data and right to privacy. The Directive explicitly stipulates that the processing of personal data 'should be limited to what is necessary for the purposes of complying with the requirements of' the 4th Directive. It is worth noting that the 4th AML Directive does not explicitly require the member states to make these registers public. The member states have the option to choose between a central or public register. In

22 European Commission, Questions and Answers: Anti-money Laundering Directive, Fact Sheet, Strasbourg, 5 July 2016, http://europa.eu/rapid/press-release_MEMO-16-2381_en.htm (accessed 10 March 2017).

either case, they are obliged to ensure that the information is available to individuals with a 'legitimate interest' in the information. Moreover, member states are allowed to at least partially restrict access, for instance by requiring some form of registration in order to obtain information, or by imposing a fee. To the extent that access is conditional on being able to demonstrate a 'legitimate interest' in acquiring the relevant data, the practical impact of this requirement will depend on how the concept of a 'legitimate interest' is construed.

The serious privacy implications of a public register of beneficial owners have sparked an intensive debate about the scope of the register. The 'obliged entities' that must be included do not cover only legal entities but also trusts. In common law countries trusts are regularly used to protect vulnerable beneficiaries, some of whom could be at significant risk should their identities be published. There were some concerns that if a new register applied to all trusts, it would be at the expense of the right of individuals to privacy. In addition, it would impose significant administrative burdens and costs on families. The current text of the 4th AML Directive applies only to taxable trusts and will not be made public. It means that only trusts that generate tax consequences will be captured by new regulations. It will only contain information that in any case is made available to tax authorities as part of international initiatives for automatic exchange of tax information. In this way, the interests of trusts used for protection of family wealth should be kept protected.

Some questions may arise with respect to the recognition of foundations by the 4th AML Directive. According to the Preamble:²³

In order to ensure a level playing field among the different types of legal forms, trustees should also be required to obtain, hold and provide beneficial ownership information to obliged entities taking customer due diligence measures and to communicate that information to a central register or a central database and they should disclose their status to obliged entities. Legal entities such as foundations and legal arrangements similar to trusts should be subject to equivalent requirements.

Foundations are also mentioned in the definition of beneficial owner. In the case of foundations, the 4th AML Directive defines a beneficial owner as 'the natural person(s) holding equivalent or similar positions to those referred' in the case of trusts. Although this seems to indicate that foundations should be listed in a central register, it is not very clear in the text of the 4th AML Directive. This may be an issue of interpretation that may only be resolved if a dispute is referred to the courts.

23 Para 17 of the 4th AML Directive.

4 UK law on new register of corporate ownership information

Among the member states, it has been the United Kingdom that has led the way with its central register.²⁴ Its proposal of a central open registry of information on companies' ultimate controllers and owners came as a result of the commitment of the UK government at the G8 Summit in June 2013. In the Communiqué issued after the summit in Lough Erne, G8 Leaders agreed as follows: 'We agree to publish national Action Plans to make information on who really owns and profits from companies and trusts available to tax collection and law enforcement agencies, for example, through central registries of company beneficial ownership.'²⁵ As a follow-up, the UK launched a process to establish a register of beneficial ownership information. The legislation received royal assent in March 2015²⁶ and entered into force on 6 April 2016.

The new law as implemented in the Small Business Enterprise and Employment Act 2015 requires companies to maintain a register of individuals who have significant control over a company.²⁷ The proposed register is known as the PSC register and is directed only to unlisted companies from the UK, since listed companies are already encompassed within the disclosure requirements provided for under the DTR 5.²⁸

The key definition under the new law is 'a person who has significant control over the company'. A person is perceived as holding significant control if he or she has met one of the following conditions:

- the individual directly or indirectly holds more than 25 per cent of the nominal share capital;
- the individual directly or indirectly controls more than 25 per cent of the votes at general meetings;
- the individual is directly or indirectly able to control the appointment or removal of a majority of the board;

24 The UK initiative has been followed by other European states, namely, by Denmark and Norway. The announcement of the Danish government as of 7 November 2014 is available at <http://borsen.dk/nyheder/avisen/artikel/11/97562/artikel.html> (accessed 17 July 2015). The Norwegian government pledged to introduce a 'publicly available, digital registry for information on shareholders of companies' on 14 May 2015, <http://www.taxjustice.net/2014/05/14/norway-pledges-introduce-public-registry-company-ownership/> or in Norwegian: <https://www.stortinget.no/no/Saker-og-publikasjoner/Saker/Sak/?p=61945> (accessed on 17 July 2015).

25 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/207771/Lough_Erne_2013_G8_Leaders_Communique.pdf (accessed 30 August 2016).

26 Small Business, Enterprise and Employment Act 2015, Royal Assent 26 March 2015.

27 Sec 81 Small Business, Enterprise and Employment Act 2015.

28 Notification of major shareholdings under the Disclosure Rules and Transparency Rules.

- the individual actually exercises or has the right to exercise significant influence or control over the company; or
- the individual actually exercises or has the right to exercise significant influence or control over any trust or firm (which is not a legal entity) that has significant control (under one of the four conditions above) over the company.

The unlisted company is required to identify and maintain an up-to-date register of persons with significant control. However, the scope of information is quite broad. The register includes a name; a residential address; date of birth (this information is protected from disclosure to the public, thereby making identity theft more difficult); a service address; and information about the way in which they have significant control. The information must be updated on an annual basis.

Companies are obliged to keep a register of people with significant control from January 2016 onwards and, as from 30 June 2016, companies' annual returns (in the future to be known as 'confirmation statements') to Companies House have to include beneficial ownership information. This information will constitute a central register. The register will be made public. This means that it will be publicly accessible. A special protection regime is also in place.²⁹ The UK legislation includes many provisions designed to ensure the non-disclosure of personal data. For example, the residential addresses of all individuals with significant control will be kept by the company. These addresses will not be available to the public and will not appear in the central public register.

The British initiative is ground-breaking. It is claimed to be the first law to introduce the public register into domestic legislation.³⁰ It is expected to improve transparency over company ownership and control to both regulatory and criminal enforcement agencies in the UK and abroad. It is estimated that the UK register will affect approximately 2.5 million companies and partnerships.³¹ Following the adoption of the 4th AML Directive, the UK law will need to be revised, but this may not happen if the UK leaves the EU.³² First and foremost, the scope of a register of individuals with significant control will need to be extended to encapsulate

29 Department for Business, Energy and Industrial Strategy, Register of People with Significant Control Guidance for Registered and Unregistered Companies, Societates Europaeae, Limited Liability Partnerships, and Eligible Scottish Partnerships (Scottish Limited Partnerships and Scottish Qualifying Partnerships) https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/621571/170623_NON_STAT_GU.pdf (accessed 12 December 2017) 29.

30 C Gascoigne 'Landmark UK transparency law raises pressure on White House' Congress, GFI blog, <http://www.gfintegrity.org/press-release/landmark-uk-transparency-law-raises-pressure-on-white-house-congress/> (accessed on 15 July 2015).

31 V Houlder 'Tax havens told to drop opposition to UK call for central register' *Financial Times* 27 March 2015.

32 In a referendum held on 23 June 2016 the majority of UK citizens voted for the 'leave' option. The UK is currently in the process of discussing with the EU the terms and conditions of its exit from the EU.

other entities in addition to companies. Also, updates of information stored in a register of people with significant control will need to occur more often to ensure that the information is current.³³

Although the UK initiative is striking, its impact necessarily is limited because, in common with all purely national registers, it can only tell part of the story. As long as registers are limited to one jurisdiction, or even to the EU, it is difficult for stakeholders and regulators to get a full picture of the global activities of all of the entities under the control of a specific individual or individuals. This is why the UK also initiated international cooperation on sharing information about the ultimate owners of companies. In its letter to the G20 countries, the UK, joined by France, Germany, Italy and Spain, indicated:³⁴

We need to take firm collective action on increasing beneficial ownership information transparency, building on our actions to date ... We commit to establishing as soon as possible registers or other mechanisms requiring that beneficial owners of companies, trusts, foundations, shell companies and other relevant entities and arrangements are identified and available for tax administration and law enforcement authorities ... As a next step, we should also call for the development of a system of interlinked registries containing full benefit ownership information and mandate the OECD, in co-operation with FATEF, to develop common international standards for these registries and their interlinking.

Currently, 55 countries have committed to participate in the pilot on exchange of information about beneficial ownership.³⁵ A global exchange

33 Department for Business, Energy and Industrial Strategy, Register of People with Significant Control Guidance for Registered and Unregistered Companies, Societates Europaeae, Limited Liability Partnerships, and Eligible Scottish Partnerships (Scottish Limited Partnerships and Scottish Qualifying Partnerships) https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/621571/170623_NON_STAT_GU.pdf (accessed 12 December 2017) 23.

34 As at 14 December 2016, 55 countries (including Crown dependencies) were committed to the initiative for the systemic sharing of beneficial ownership information: France, Germany, Italy, Spain, United Kingdom, Afghanistan, Anguilla, Argentina, Austria, Belgium, Bermuda, Brazil, British Virgin Islands, Bulgaria, Cayman Islands, Chile, Colombia, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, Gibraltar, Greece, Guernsey, Hungary, Iceland, India, Ireland, Isle of Man, Jersey, Latvia, Liberia, Lithuania, Luxembourg, Malta, Mauritius, Mexico, Moldova, Montserrat, Netherlands, Nigeria, Norway, Poland, Portugal, Romania, Saudi Arabia, Seychelles, Slovakia, Slovenia, Sweden, Turks and Caicos Islands and United Arab Emirates. See updates on <https://www.gov.uk/government/publications/beneficial-ownership-countries-that-have-pledged-to-exchange-information/countries-committed-to-sharing-beneficial-ownership-information> (accessed 10 March 2016).

35 As at 8 June 2016, the following countries committed to sharing beneficial ownership information: Afghanistan, Anguilla, Austria, Belgium, Bermuda, Bulgaria, Cayman Islands, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Gibraltar, Germany, Greece, Hungary, Iceland, India, Ireland, Isle of Man, Italy, Jersey, Latvia, Lithuania, Luxembourg, Malta, Mexico, Montserrat, Netherlands, Nigeria, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, United Arab

of beneficial ownership information will complement the Common Reporting Standard.³⁶ Nevertheless, even this initiative is highly dependent on the consistency of implementation and may need to be supported by a process of peer review, along the same lines as already existing for EOI for tax (through the Global Forum).

5 Global LEI system

5.1 Rationale of the initiative

The idea of the Global LEI system was developed in the aftermath of the global financial crisis. The fragmented system of firm identifiers and the lack of a standard identification system for financial counterparties were blamed for the inability of market participants to form a consistent and integrated view of their exposures. In 2009, the G20 called for the strengthening of financial markets and the harmonisation of existing standards.³⁷ Later, in 2012, it supported the creation of the Global LEI system and mandated the Financial Stability Board (FSB) to deliver concrete recommendations. The LEI was designed to become a global standard governed within the Global LEI system to support authorities and market participants in identifying and managing financial risks. Thus far, the initiative has been endorsed by many countries as well as the EU. At the moment, the standard is being developed at domestic levels.

5.2 Scope and purpose

As stated by the FSB,³⁸ financial stability demands improved risk management; better assessment of micro and macro-prudential risks; facilitation of orderly resolution; containing market abuse and curbing financial fraud; and enabling higher quality and accuracy of financial data overall. The Global LEI system attempts to achieve these objectives by offering harmonised standards of entity recognition. The system is based

Emirates and the United Kingdom. See updates on <https://www.gov.uk/government/publications/beneficial-ownership-countries-that-have-pledged-to-exchange-information/countries-committed-to-sharing-beneficial-ownership-information> (accessed 8 June 2016).

36 The Common Reporting Standard (CRS) is the single global standard for the collection, reporting and exchange of financial account information on foreign tax residents developed in the context of the OECD. It addresses banks and other financial institutions. These two types of institution are obliged to collect and report financial account information of non-residents to the tax administration. This information will be exchanged by the tax administration with the participating foreign tax authorities of those non-residents. Simultaneously, financial account information on residents from the tax authorities of other countries will be received. The results of CRS should be twofold. This should work as a deterrent to tax evasion. In addition, residents with financial accounts in other countries should be encouraged to comply with tax law.

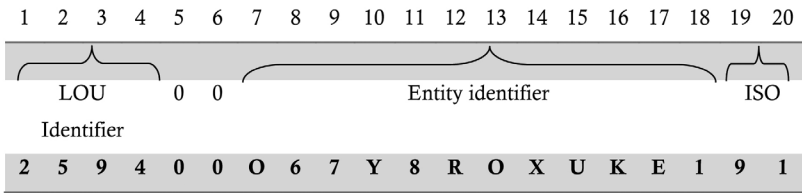
37 G20 Leaders Statement: The Pittsburgh Summit, 24-25 September 2009, Pittsburgh.

38 Financial Stability Board *A global legal entity identifier for financial markets* 8 June 2012.

on ascribed unique codes, namely, the LEIs. It facilitates the creation of a robust data framework offering information on positions, exposures and risks between financial groups.

Technically speaking, the LEI, which is the core of the Global LEI system, is an alphanumeric code that enables identification of entities participating in global financial markets. Currently, it relies on a standard published by the International Organisation for Standardisation (ISO) on 30 May 2012 (ISO 17442:2012, Financial Services – Legal Entity Identifier (LEI)). It consists of 20 characters (numbers or letters), and their allocation within the code is not random. The first four characters reflect a prefix allocated uniquely to each Local Operating Unit (LOU) issuing LEIs. This prefix identifies (except for LEIs issued before 30 November 2012) the LOU that first issued the LEI, which helps to avoid the assignation of the same LEI to different LOUs. The entity may transfer its LEI to a different LOU. The next two characters (numbers 5 and 6) are always specified at zero. The following 12 characters (numbers 7 to 18) are the identification code of an entity. This part of the code is then entity-specific and is assigned by the particular LOU. The last two characters (numbers 19 and 20) are two check digits that are designed to prevent typing errors. They are assigned according to the standard ISO/IEC 7064 (MOD 97-10). Figure 9.1 presents the architecture of the code.

Figure 9.1: Architecture of the Legal Entity Identifier



Example: ERSTE Securities Polska SA.

There are two fundamental features of the LEI which reflects its character. First, it is *unique*, which indicates that a particular code is assigned to a specific entity and, even if this entity ceases to exist, the code cannot be reassigned to another entity. Second, the LEI is *exclusive*. The same entity can obtain only one LEI. The entity may decide to change its LOU, but even then the LEI will remain the same.

Not all entities may obtain the LEI. According to the ISO standard, the LEI identifies only legal entities involved in financial transactions. The term 'legal entities' refers to unique parties that are legally or financially responsible for the performance of financial transactions or have the legal

right in their jurisdiction to enter independently into legal contracts regardless of whether they are incorporated or constituted in some other way (for instance, by means of a trust, partnership, or other contractual mechanism). It also includes governmental organisations and supranationals, but natural persons are excluded from its scope.

The Global LEI system is being built in a few stages. In the first phase, legal entities applying for a LEI need to provide only the reference data (the 'who is who'). The reference data consists of the basic information about the entity (see details in Table 1). Currently, the Global LEI system is moving to the second stage. Entities applying for the LEI (or who already have one) will be obliged to provide a much wider scope of information, namely, relationship data ('who owns whom'). Relationship data will cover first data on direct and ultimate parents of legal entities³⁹ as well as data about branches (see Box 9.1). There are already plans to develop a new policy with respect to individuals acting in a business capacity.⁴⁰ In the future we may expect that the third step will cover financial data ('who owns what').

Box 9.1: The LEI reference data

The code is linked to data that refer to **the basic information about the entity**. The reference data include:

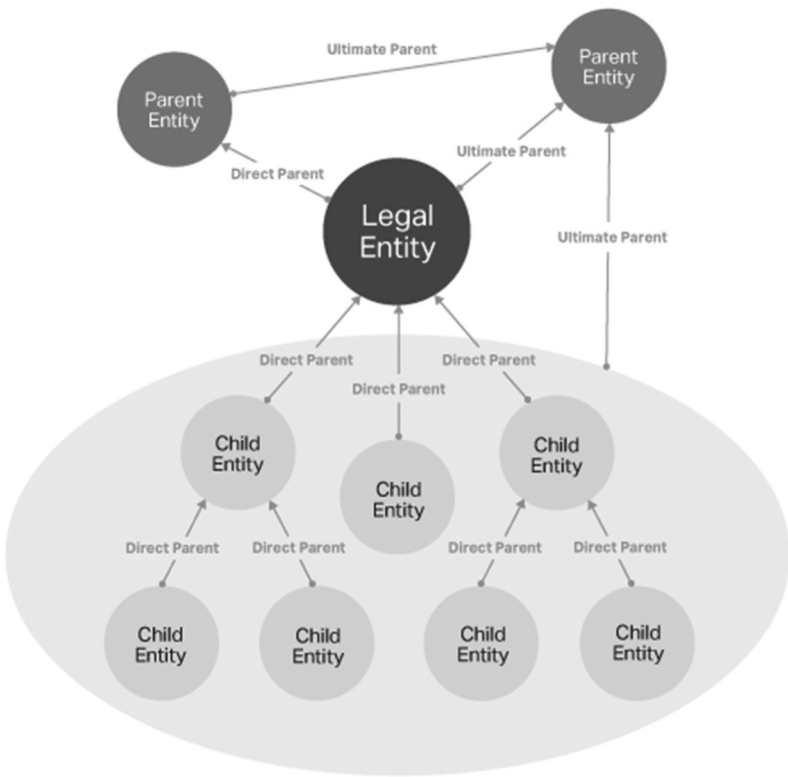
- the official name of the legal entity;
- the address of the headquarters of the legal entity;
- the address of legal formation;
- the date of the first LEI assignment;
- the date of last update of the LEI;
- the date of expiration, if applicable;
- for entities with a date of expiration, the reason for the expiration should be recorded and, if applicable, the LEI of the entity that acquired it;
- the official business registry where the foundation of the legal entity is mandated to be recorded on formation of the entity, where applicable;
- the reference in the official business registry to the registered entity, where applicable.

39 Currently, the technical specifications for recording the relationship data are finalised in consultation with LEI Issuers. It was expected that by 1 May 2017 all LEI Issuers will have developed the capacity to record relationships with direct and ultimate parents. See LEI ROC, Update by the LEI ROC, 12 January 2017.

40 This will refer to independent business activity as evidenced by registration in a business registry, eg, a sole trader.

Data on direct and ultimate parent legal entities will be provided based on the accounting definitions. This means that a direct parent legal entity will be identified as a ‘direct accounting consolidating parent’ and the ultimate parent legal entity as the ‘ultimate accounting consolidating parent’. The ‘relationship’ is explained in Figure 9.2.

Figure 9.2: Relationship Data



Source: GLEIF website: <https://www.gleif.org/en/lei-data/access-and-use-lei-data/level-2-data-who-owns-whom>.

5.3 Infrastructure for operating LEI

The ultimate responsibility for the system was entrusted to the *Regulatory Oversight Committee* (ROC).⁴¹ This body was established by the Charter of the Regulatory Oversight Committee for the Global Legal Entity Identifier (LEI) System on 5 November 2012.⁴² It is comprised of representatives of public authorities from around the globe. The ROC is responsible for upholding governance principles and for overseeing the entire system. It releases guidance, standards, high-level plans, policies and protocols.⁴³

The operational arm of the whole system is served by the Global LEI Foundation (GLEIF) which provides a centralised database of LEIs and corresponding reference data that can be downloaded free of charge. Since October 2015, the GLEIF has been evaluating organisations that issue LEIs to legal entities engaging in financial transactions, and is responsible for the accreditation of LEI organisations. The GLEIF annually verifies whether organisations that are accredited to issue and maintain LEIs continue to meet the requirements regarding service orientation and quality as established in the Master Agreement. It aims at optimising the quality, reliability and usability of LEI data.

To obtain the LEI, an entity must register with one of the LOUs.⁴⁴ Each LOU may differ with respect to the available languages, facilities to register many entities in bulk, and price, among others. Nevertheless, certain requirements are common. In particular, each LOU needs to collect a minimum set of reference data (as presented above) about the entity that must be confirmed or certified by the entity seeking an LEI. Entities are requested to periodically verify whether the reference data are accurate. A LOU is in charge of ensuring the quality of data. It is obliged to examine each entry against reliable sources (public official sources such as a business registry or private legal documents) before the LEI and associated reference data is published.⁴⁵ It should ensure that an entity reviews the accuracy of this information at least once annually and promptly submit any changes. LOUs may charge a fee for issuing the LEI as well as for validating the reference data upon issuance and after each yearly certification. Figure 9.3 sets out the LEI hierarchy.

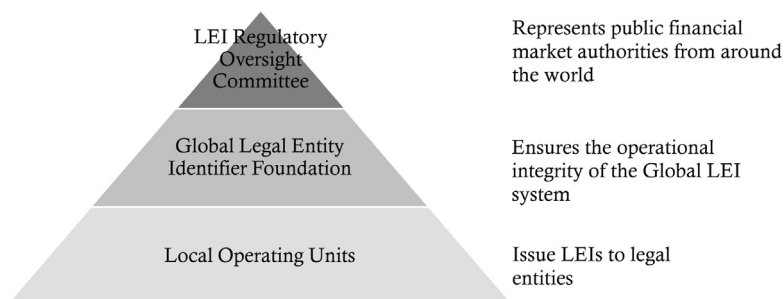
41 The ROC is composed of the Plenary, the Executive Committee, the Committee on Evaluation and Standards and other committees, working groups or panels. Moreover, it has a Secretariat located in Basel, Switzerland.

42 http://www.leiroc.org/publications/gls/roc_20121105.pdf (accessed 30 May 2015).

43 Art 2(b)(1) of the Charter.

44 The list of pre-LOU is available on the website <http://www.leiroc.org> (accessed 10 January 2017).

45 The ultimate responsibility for data accuracy falls upon the registrant.

Figure 9.3: LEI Hierarchy

5.4 Regulatory application

Consistent with the goal to implement the LEI as the global standard and create the Global LEI system, the tool has already been employed in many regional legal frameworks. Approximately 40 regulatory actions require use of the LEI. So far, the standard is being used in the securities, banking and insurance sectors.⁴⁶ Two examples of its implementation are presented below.

The first regulator to mandate the use of an identifier in regulatory reporting was the US Commodity Futures Trading Commission (CFTC). The first regulation, which entered into force on 12 October 2012, effected OTC interest rates and credit derivatives. It was later extended to OTC foreign exchange, commodity and equity derivatives. The rule requires the identification with standard identifiers of the parties, their counterparties, and any underlying reference entities of the contracts. The CFTC requires the use of a CFTC Interim Compliant Identifier (CICI) until the global LEI programme is implemented. To facilitate compliance with this requirement, a special utility was introduced by the CFTC. Market participants who are required to obtain a CICI can use the CICI website <http://www.ciciutility.org>. The website can be used at no charge and is available to the public. It is owned, managed and operated by DTCC-SWIFT.

Apart from the US, the use of the LEI has been mandated by the European Securities and Markets Authority (ESMA) for reporting derivative transactions to Trade Repositories under the European Market

46 LEI ROC, Progress Report by the Legal Entity Identifier Regulatory Oversight Committee (LEI ROC) 5 November 2015 10, http://www.leiroc.org/publications/gls/lou_20151105-1.pdf (accessed 10 September 2016).

Infrastructure Regulation (EMIR). According to delegated regulations adopted under the European Markets Infrastructure Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012, on OTC derivatives, central counterparties and trade repositories which impose the reporting obligation, an LEI is required for reporting details of concluded derivative contracts to a trade repository.

The LEI as a standard in financial transactions has also been implemented in many other legal fora. It appears that the tool is gaining increasing worldwide recognition. According to the Global Financial Market Association (GFMA), as of January 2017, approximately 490 000 LEIs have been issued.⁴⁷ Of these, more than 90 per cent have been issued in Europe and North America.

5.5 Considerations and challenges in implementing the LEI as a global standard

The LEI is a public-private initiative. Certain benefits are expected for both regulators and business. The former demands an effective tool that can assist them in data aggregation and analysis between financial market participants. It should also provide the ability to identify trading patterns. Moreover, it should also offer an accurate risk assessment to the financial system. The key functionality should be the ability to analyse risk at an aggregate firm level. From the perspective of business, the Global LEI system should make it easier to more effectively measure and manage counterparty exposure. This could be achieved through a common perspective of legal entities across the organisation. It should improve the speed and accuracy of data aggregation for risk analysis and for managing corporate actions.

Some challenges still need to be addressed to ensure that the Global LEI system will be a successful experience for all market participants. Size matters: The Global LEI system was developed with an ambition to become the global standard. As a result, the success of the Global LEI system requires a significant commitment from all stakeholders. Because the benefits of the system are collective, they may only be fully realised once there is broader public participation. The fundamental question is how to ensure that the system is widely adopted. One way is to promote the benefits that the global standard could generate. However, it is not certain whether a voluntary solution could create wider buy-in and become an internationally recognised standard. It would certainly require intense political pressure. It seems that establishing LEI as a global system would be much more likely if it were established as a compulsory condition to enter certain markets. Consequently, regulators around the globe need to

⁴⁷ Webinar slides *The Legal Entity Identifier System* 1 February 2017 (accessed 10 March 2017).

be encouraged to make use of the LEI as one of their compulsory requirements whenever a legal entity is to be identified and established as a market participant.

As far as risks are concerned, there are some concerns that suppliers of LEIs will exploit their position by overcharging registrants or by restricting access to data. Therefore, regulators must ensure that public interest will be protected in a manner that will make the system fully efficient and effective. To do so will demand introducing clear principles and standards governing this framework. This should be assured and monitored within the accreditation process governed by the GLEIF. To have a competence to issue a LEI, an authority must obtain a certificate of accreditation from the GLEIF.

The system will facilitate integration of different jurisdictions with varied regulatory, legal systems, and local languages from around the world. The Global LEI system should be responsive to these differences, while enabling the cooperation of all jurisdictions within a common framework. As a corollary, it should have enough capacity to be able to expand across the globe, including to the least developed countries. This dimension seems to be very dependent on political discretion. At the end of the day, it is up to domestic regulators to decide whether or not the LEI is required.

The need for integration of different regulatory and legal systems has very practical implications for the development of the Global LEI system. It has been evident in discussions on relationship data. Adding data on parent entities first required identification of what is meant by the terms 'direct parent' and 'ultimate parent'. For this purpose, the ROC reviewed existing international standards, principles and best practices.⁴⁸ To minimise the potential for overwhelming complexity, it was decided to base definitions on the accounting definition of consolidation applying to this parent.

The Global LEI system, first and foremost, will be a significant source of data about market participants from around the world. The first concern is how this data will be updated. This was already an issue when the concept of LEI was first presented. The burden was divided between a LOU and an entity. The LOU validates and publishes data and next annually revalidates data. The entity registers and provides the reference data and then provides an annual update. In light of the new standard of relationship data, the process may become more complex. In particular, the validation of data may require more efforts from LOUs. As some

48 The review covered different standards ranging from those used for the purpose of banking supervision to anti-money laundering and countering the financing of terrorism. See LEI ROC 'Collecting data on direct and ultimate parents of legal entities in the Global LEI Systems – Phase 1' 10 March 2016 4.

indicate, this may be not sufficient. An independent source of entity corporate actions may be required to govern and manage the reporting process.⁴⁹

There are also concerns about the costs involved. The more complex the structure of a group of companies, the more significant the costs involved. This may be a particular issue for least developed countries. Scarce capacities pose a real issue there. For these countries, ensuring a reliable process of validation of data may be an obstacle to joining the Global LEI System. To achieve accreditation from the GLEIF, the LOU needs to be able to comply with the operational and technical standards and protocols.

Moreover, simply collecting data is not a solution. Analysts needs a tool that would allow them to track the links existing between companies located in different national jurisdictions. This would require additional capacities for connecting and analysing databases.

Of even greater concern is the issue of data protection. Confidentiality and privacy restrictions could pose an enormous challenge when structuring such a system to function on a global scale. In order to avoid the abuse of information, a proper system of protection must be ensured. However, finding an effective solution could be a challenge to regulators. The question is whether lessons can be learnt from the EU experience with the 4th AML Directive. As discussed, in order to avoid any abuse of the information collected under this Directive, member states are not required to make their registers public. Moreover, in addition to specified authorities, only those with a 'legitimate interest' in the information contained in the registers will be allowed to access to the registers. Numerous other exceptions designed to protect the confidentiality of information are provided for. In the UK legislation, there are special provisions addressing the issues of data protection.

5.6 Blockchain as a potential solution

Perhaps the answer to these challenges can be found in the digital sphere. In particular, Blockchain technology may be an appropriate platform for the Global LEI system.

Blockchain is a decentralised ledger that tracks transactions of digital assets. It can be applied for tracing currency, stocks and bonds, or identity details. The network is made up of a chain of computers, each of which has a copy of the ledger and is able to see whether any changes have occurred.

⁴⁹ AP Dolaney (ed) 'The global LEI System: A solution for entity data?' December 2013, ReferenceDataReview.com.

Blockchain technology is seen as secure as all the computers in the network must verify and approve each transaction as it takes place.

Blockchain technology has already proved relevant to identity databases. Blockchain technology relies on data stored by individuals in a type of locker or escrow account, allowing people to access it on a need-to-know basis. In this way, it reverses the traditional method for establishing identity. Typically, identity is conferred by a national government, which certifies who an individual is and records this in a database. Using Blockchain technology, individuals create and store their own identity on networks of computers that no one person or entity controls, establishing a 'self-sovereign identity'.

This could be a way of establishing a truly global LEI system. Entities could create and store their own identity on networks of computers. The requirement for registration would be embedded in the structure of the network, eliminating the need for actively supervising the registration process. It would establish a 'self-sovereign identity'. This could eliminate the need for validation of data which is the greatest source of concern in the context of LEI. It may ensure a relatively smooth process of ensuring that data is up-to-date. As a result, Blockchain technology has the potential of significantly minimising any costs that the Global LEI system may imply. Blockchain technology could drive simplicity and efficiency across the entire process of setting, managing and updating the Global LEI system.

Moving to digital identity underpinned by Blockchain technology would also mitigate the current risk of information loss or theft. It streamlines and de-risks completion of public and private transactions. Currently business often suffers fraud resulting from stolen or incorrect data or poor identification.⁵⁰

However, regardless of how beneficial it may be for building the Global LEI system, it requires a concerted and co-ordinated effort. The implementation of digital identity is still perceived as a sensitive issue and addresses situational, operational and cultural factors, all of which are important for the development of digital systems. These are some of the non-technical barriers that implementation of the new technology would need to answer. Political consensus as well as agreement among market participants would be essential.

50 World Economic Forum 'A blueprint for digital identity. The role of financial institutions in building digital identity', http://www3.weforum.org/docs/WEF_A_Blueprint_for_Digital_Identity.pdf (accessed 14 March 2017).

The GLEIF recently launched a research project called GLEIS 2.0.⁵¹ The project is considering the potential of using Blockchain technology.

6 Global LEI system and curbing illicit financial flows

The LEI and the Global LEI systems collect data that may contribute to the prevention of money laundering and other types of illicit financial flows.⁵² These systems could play a significant role in increasing the effectiveness of know-your-customer due diligence, particularly in correspondent banking. Since the know-your-customer due diligence process is complex, costly, time-consuming and labour-intensive, special utilities were designed with the intent of storing relevant due diligence information in a single repository. The Global LEI system could become an efficient global standard for the purpose of these utilities and information sharing mechanisms by offering a centralised database.⁵³ Moreover, the widespread use of LEI could assist financial institutions to identify specific entities with a high level of certainty and increase the effectiveness of automatic screening packages, particularly for identifying sanctioned entities.⁵⁴ The LEI may also facilitate the consolidation of information received in financial intelligence units by more easily identifying transactions undertaken by the same entity but reported by different financial institutions.⁵⁵

7 Global LEI system and a Global Beneficial Ownership Register

The Global LEI system is a model that was developed by a regulatory will with a global reach. Currently, many discuss the need for developing another global register. A number of scandals, from the Swiss UBS bank scandal and the Lichtenstein tax data leak, to the Offshore Secrets leaks and the Panama Papers, have revealed the need for more transparency with respect to beneficial ownership information. The question is what the lesson is to be drawn from the experience with the Global LEI system to design of a Global Beneficial Ownership Register.

51 GLEIF, Minutes GLEIF Board of Directors Meeting, https://www.google.at/url?sa=t&rct=j&q=&esrc=s&source=web&cd=7&ved=0ahUKEwimq9av98zSAhWKiSwKHXMVABIQFghbMAY&url=https%3A%2F%2Fwww.gleif.org%2Fcontent%2F1-about%2F6-governance%2F7-board-minutes%2Fminutes-gleif-board-meeting-26-2016-10-27.pdf&usq=AFQjCNEFfJEXN430xEM_6HaDegEx-VIX6A&sig2=YBRyFFicUcAwH_uj2F0KpA (accessed 10 March 2017).

52 Committee on Payments and Market Infrastructures, Consultative Report. Correspondent banking, October 2015.

53 Committee on Payments and Market Infrastructures (n 52 above) 16.

54 As above.

55 As above.

Undoubtedly, the Global LEI system proved that the current technology allows to build a global system. It is possible to gather global interests and incentivise different entities from around the globe to sign up for a global register. Nonetheless, the current framework has some significant limitations. These limitations may have significant implications for the idea of a Global Beneficial Ownership Register.

First, the Global LEI system excludes natural persons. The LEI does not identify who a natural person in control of an entity is. It refers only to entities that belong to the same corporate group. Also, the latest update on scope of information available within the Global LEI system, which is the implementation of relationship data, does not cover who a beneficial owner is. The collection of data about parent entities under the LEI is distinct from the identification of the beneficial owner as defined under the FATF Recommendations⁵⁶ or under the Common Reporting Standard.⁵⁷

Second, the LEI captures a well-defined group of entities. Only the population of regulated market participants are obliged to apply for a LEI. In the case of the Global Beneficial Ownership Register, it is practically impossible to define who the group of beneficial owners are. It certainly goes beyond the scope of entities obliged to apply for an LEI.

Third, market participants who are obliged to get a LEI have a clear motivation for registration. They have an interest in acquiring information about their counterparty. This explains why the Global LEI system gained the support of many regulators across the world. It would not be the case for beneficial owners registered in the Global Beneficial Ownership Register. In the current legal, institutional and regulatory framework, beneficial owners have no motivation to disclose their data and be a part of any registry. This raises the question of what benefits should be offered to beneficial owners to support this initiative.

This comparison illustrates that establishing the Global Beneficial Ownership Register, although a feasible task from a technological point of view, may need to overcome more practical hurdles. What may these be?

The first issue refers to trusts. As was seen, the Global LEI system relies on a common interest of capital market participants in assuring financial stability. Trusts that do not participate in the regulated capital market, especially those set up by wealthy individuals in offshore jurisdictions, do not share this interest. What incentives could then be provided to them?

56 LEI ROC (n 46 above) 18.

57 In the process of identifying the owner of the financial account, the Common Reporting Standard relies on the FATF definition of beneficial owner. See OECD Standard for Automatic Exchange of Financial Account Information on Tax Matters 204 57.

The second question addresses the conditions for regulation of retail investments. The current framework does not require retail investors to register. In fact, the scope of LEI is limited only to investment firms. It means that as long as someone invests in his own capacity, and not as an intermediary, there is no obligation to report using a LEI. It is a significant limitation to a scope of entities potentially covered by the register. How can that be changed? It seems that it is up to regulators to decide whether retail investors should also use a LEI.

Finally, the third doubt is whether we can unknowingly agree on the designatory data to be supplied. Perhaps the Common Reporting Standard can provide an interesting example. The Common Reporting Standard is built upon the FATF definition of beneficial owner.⁵⁸ This means that reporting persons obliged by the standard to provide information to financial institutions are any natural persons that meet the definition of a beneficial owner as set by the FATF. It means that the standard captures all beneficial owners that own a specified financial account. There is still a need for a register that supplements the available information by providing some data on other beneficial owners that will not be captured by the standard.

8 Opportunities for developing countries

The promotion of a global register could be especially beneficial for developing countries that suffer from market abuse, tax evasion, aggressive tax planning and other types of illicit financial flows. Many of the least developed countries have substandard institutions and inadequate regulatory structures. The existence of legal loopholes and financial secrecy exacerbate the situation, making them even more susceptible to abuse. All of these factors contribute to entrenched impunity of those benefiting from illicit flows, which substantially weaken their economies. The ineffective response to this challenge is too often the responsibility of a fragmented network of different law enforcement agencies, tax administrations and financial intelligence units that neither cooperate nor undertake coherent operations.⁵⁹ This is why setting up a domestic register – as is the case in the EU – might be not feasible at the moment in many of the least developed countries.

The Global LEI system could offer developing countries several effective solutions to existing problems. The system has the capability to improve the efficiency of their resource-constrained agencies. At the same

⁵⁸ As above.

⁵⁹ Report of the High Level Panel on Illicit Financial Flows from Africa commissioned by the AU/ECA Conference of Ministers of Finance, Planning and Economic Development 13, http://www.uneca.org/sites/default/files/publications/iff_main_report_26feb_en.pdf (accessed 10 June 2016) 13 (UNECA Report 35).

time, the increased uniformity on available information would also simplify procedures and make them much less expensive. The cost of participation in the Global LEI would be limited to the issuance of the new law imposing obligations on market participants to employ the LEI when concluding contracts. From the perspective of developing countries, the crucial advantage of the Global LEI system is that it is financed by fees paid by legal entities. Countries deciding to rely on the LEI within its regulatory framework do not have to bear any additional costs. In this way, participation in the Global LEI system would directly impact developing countries' ability to access information.

Since the Global LEI will aggregate information from most jurisdictions, the limited treaty network that currently appears to be a critical issue and prevents an intensive exchange of information would disappear as a barrier for tracing or detecting illicit activities. Although it is now changing and many less-developed countries joined the Multilateral Convention on Mutual Administrative Assistance,⁶⁰ the capacity to safely store and use data is still a common issue. These countries are not able to track financial flows. The Global LEI system could solve this problem by offering access to the collection of data.

9 Conclusions

Accomplishing genuine change and improving the transparency demands global answers. It appears to be a prerequisite of building the effectiveness of legal, regulatory and institutional frameworks with respect to beneficial ownership transparency. Only those solutions having worldwide scope will effectively prevent tax avoidance, tax evasion and other types of illicit financial flows.

Most regulators have insufficient data and this is a particularly crucial issue for developing countries. Although many countries are now moving for domestic registers, the question remains of how to access data cross-border. Developing one common register would overcome these issues. It would minimise the need for the exchange of information and substantially contribute to a better allocation of scarce resources. Additionally, it would contribute to aligning standards in different regulatory areas, for example, taxation or finances. From this perspective, the 4th AML Directive may be a good example, but its regional scope may prove to be its most significant weakness.

The Global LEI system could be the answer. Although it was designed to address only specific types of abuse, it could be of benefit to all regulators and contribute to minimising all types of illicit activities.

60 <http://www.oecd.org/ctp/exchange-of-tax-information/convention-on-mutual-administrative-assistance-in-tax-matters.htm> (accessed 20 October 2016).

Drawing a distinct line between market abuse and other types of abusive practices is sometimes difficult. For example, money laundering activities usually also involve market abuse, whereas aggressive tax planning schemes constitute financial abuses. Considering this, the Global LEI system could serve as a powerful source of data which could be utilised by financial regulators, financial intelligence units, tax administrations, and different law enforcement agencies to detect, track, and investigate not only market abuse but all types of illicit activities. Already it has the ambition of becoming relevant for statistics on the balance of payment or in the tax area, in competition laws, combatting financial crime or in public procurement.⁶¹

The Global LEI system is the best evidence that it is a feasible task to establish a global register. The digitalisation of the LEI could facilitate many processes and mitigate some risks the standard is currently facing. The Global LEI system, when underpinned by the Blockchain technology, particularly could address some security risks and ensure up-to-date information.

However, there are many doubts as to how to create a Beneficial Ownership Register out of it. The Global Beneficial Ownership Register would require to capture a much wider scope of entities than is currently covered by the Global LEI system. As long as wholesale investors only are obliged to use a LEI, the relevance of the Global LEI system is limited. Regulatory willingness is essential to change the rules of the game and obligate other entities to participate in this register. These and other issues will have to be addressed if the global Beneficial Ownership Register were to be established.

Currently, there is no alternative international tool of a global reach. Certain interesting features may be found in the Common Reporting Standard. It gathers data on beneficial owners of financial accounts from all countries around the world that committed to the standard. However, the standard will neither collect data in a global register nor cover all beneficial owners.

Increasing transparency about corporate entities is highly relevant. The global initiative, such as the Global LEI system, provides a unique opportunity to connect corporate dots from all around the globe. Although the Global LEI system is still moving rather slowly, undoubtedly the initiative contributes to making the scenario of global corporate activity slightly less opaque. Therefore, at least it deserves support.

61 LEI ROC 'Collecting data on direct and ultimate parents of legal entities in the Global LEI Systems – Phase 1' 10 March 2016 5.

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