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Beneficial Ownership Secrecy

The hidden control of corporate vehicles and its regulation through international law

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1 Introduction

This thesis examines the legal issues arising from the secrecy of beneficial ownership behind corporations in light of the international legal framework for the prevention of money-laundering and corruption. It further examines the effectiveness of such international legal instruments.

The concerns surrounding the identification of those who, in reality, control a corporate vehicle - beneficial owners - can be traced to the last century. In 1937, a letter from the Secretary of Treasury to President Roosevelt regarding tax haven jurisdictions like Newfoundland stated the following:

[T]heir corporation laws make it more difficult to ascertain who the actual stockholders are. Moreover, the stockholders have resorted to all manner of devices to prevent the acquisition of information regarding their companies. The companies are frequently organized through foreign lawyers, with dummy incorporators and dummy directors, so that the names of the real parties in interest do not appear.¹

If the same letter was written today - 80 years after - it would still be relevant. Indeed, many of the concerns expressed by the American Secretary of the Treasury remain relevant. The inability to identify persons who ultimately control a corporate vehicle significantly undermines anti-money laundering ("AML"), combating the financing of terrorism ("CFT"), and anti-corruption actions.²

The "Panama Papers" case, as perhaps the most famous example, serves to illustrate this point. More than two hundred thousand offshore entities were represented by the law firm Mossack Fonseca, which provided services in connection with a very large range of illicit activities, such as tax evasion, money laundering, corruption, fraud, and even evasion of international sanctions. This law firm in Panama had a "successful business" as a direct result of a combination of a weak domestic regulatory framework, and a client-attorney privilege

¹ *Report of the Joint Committee on Tax Evasion and Avoidance* (Washington: Government Printing Office, 1937), 2.

² See Emile van der Does de Willebois et. al., *The Puppet Masters: How the Corrupt Use Legal Structures to Hide Stole Assets and What to Do About It* (Washington: The World Bank, 2011), Organization for Economic Cooperation and Development, *Behind the Corporate Veil Using Corporate Entities for Illicit Purposes* (Paris: OECD, 2001), and Financial Action Task Force, *Guidance on Transparency and Beneficial Ownership* (Paris: FATF/OECD, 2014).

exploitation, that enabled the concealment of crucial information from authorities, especially beneficial ownership.³

Therefore, the issues surrounding secretive beneficial ownership persist in modern times and the consequences are far-reaching. Given the transnational nature and impact of these issues, they need to be tackled by the international community as a whole. In preceding decades, international instruments have been developed to address such issues, unfolding into a series of binding obligations to countries, who have the responsibility to implement them into their respective domestic legal systems.

These binding obligations established by the international instruments have two different dimensions: preventative and the enforcement. The preventative dimension establishes the regulatory framework with the minimum measures that states must implement, in order to avoid beneficial ownership secrecy. The enforcement dimension imposes sanctions to deter transgressions of the preventative requirements, and thus facilitate compliance. This paper addresses the concept of "beneficial ownership" in view of the current international framework, limiting its scope to the preventative dimension. The enforcement dimension is addressed briefly only when it is pertinent to this paper's discussion.

Despite the existence of international legal instruments which are designed to regulate beneficial ownership, major scandals have continued to emerge in recent decades. Along with the "Panama Papers", the "Luxembourg papers",⁴ and the "HSBC Scandal"⁵ have highlighted the issue of beneficial ownership regulation. Most recently, the International Consortium of Investigative Journalists reported the leak of millions of confidential electronic documents relating to offshore investments in multiple jurisdictions considered "tax havens". The leak, termed as the "Paradise Papers", involved politicians and some of the biggest companies in the world, which exploited the beneficial ownership secrecy offered by certain jurisdictions.⁶ Other international scandals involving beneficial ownership secrecy that recently surfaced are the FIFA bribery case, and the "Lava-Jato case", related to the Brazilian oil company,

³ International Consortium of Investigative Journalists, "The Panama Papers: Giant Leak of Offshore Financial Records Exposes Global Array of Crime and Corruption", last modified 3 April, 2016 <https://www.icij.org/investigations/panama-papers/20160403-panama-papers-global-overview/>

⁴ International Consortium of Investigative Journalists, "New Leak Reveals Luxembourg Tax Deals for Disney, Koch Brothers Empire", last modified 9 December, 2014. <https://www.icij.org/investigations/luxembourg-leaks/new-leak-reveals-luxembourg-tax-deals-disney-koch-brothers-empire/>

⁵ International Consortium of Investigative Journalists, "Private Bank Secrets Revealed" last modified 12 February, 2015. <https://www.icij.org/investigations/swiss-leaks/>

⁶ International Consortium of Investigative Journalists, "The 'Paradise Papers' and the Long Twilight Struggle Against Offshore Secrecy", last modified 27 December, 2017 <https://www.icij.org/investigations/paradise-papers/paradise-papers-long-twilight-struggle-offshore-secrecy/>

Petrobras. Notably, it is estimated that 8% - around US\$7 trillion - of the world's personal financial wealth is located in secret offshore accounts.⁷

The continued exploitation of beneficial ownerships structures - and the inherent secrecy of these vehicles - may cause one the question the effectiveness of the relevant international legal instruments. This paper will also address the question of whether these international instruments are effective at combatting these challenges.

1.1 Legal method and sources of law

The legal method adopted in this paper is a descriptive analysis of the legal rules of primary sources of international law. This paper systematically presents the inter-related norms and confront their legal significance through the authoritative commentaries of academic authors, and through technical policy papers issued by international organizations. The conclusions reached in these technical policy papers are based on a fact-basis analysis of corruption cases, and interviews conducted with experts. It must be highlighted here, that it is sometimes challenging to find academic sources dealing explicitly to beneficial ownership. Such sources are scarce, even in terms of commentaries to the international legal instruments.

That said, the primary source of international law used on this paper is the UN Convention Against Corruption (2003) ("UNCAC"). With 140 signatories and 183 State Parties to date, the Convention is the only legally binding instrument to establish beneficial ownership information as a mandatory obligation to countries as part of the preventative system to combat money-laundering and corruption. Additionally, the Vienna Convention on the Law of the Treaties ("VCLT") is adopted by this thesis as an indispensable tool of treaty interpretation. Particularly, articles 31 and 32 of the VCLT provide the admissible interpretational rules of international law, and, thus, are applicable to the instruments discussed in this paper.

Certain soft law instruments were also considered due to their significant relevance for the purposes of this paper. One of them is the Legislative Guide for the Implementation of the UN Convention Against Corruption (2006). Issued in 2006, the Legislative Guide was developed through several steps which incorporated the participation of experts from different geographical regions and systems of law, government representatives, the Council of Europe, the United Nations, and the Organization for Economic Cooperation and Development

⁷ James S. Henry, "The Price of Offshore Revisited", *Tax Justice Network* (2012): 20-23, retrieved from https://www.taxjustice.net/wp-content/uploads/2014/04/Price_of_Offshore_Revisited_120722.pdf

("OECD").⁸ This non-binding instrument was drafted for policymakers and legislators of States to aid them in the implementation of the Convention.⁹ The Legislative Guide is relevant insofar as it assists with the interpretation of the articles of the Convention.

Another important soft law instrument is the Technical Guide to the UN Convention Against Corruption (2009), jointly developed by the United Nations Office on Drugs and Crime ('UNODC') and the United Nations Interregional Crime and Justice Research Institute ('UNICRI'). While implementing the Convention, State Parties need to take into account a series of considerations and adopt policy options that best fit into their respective legal systems. The objective of the Technical Guide is to assist countries on this matter.¹⁰ The Technical Guide is relevant for the interpretation of the Convention given its institutional authority. Accordingly, both the Legislative Guide and the Technical Guide are used by this paper when interpreting the terms of the Convention.

At this point, it is worth recalling that the United Nations Charter (1945) commands Member States "to establish conditions under which justice and respect for the obligations arising from treaties and other sources of international law can be maintained".¹¹ In order to achieve such respect for international law, the United Nations ('UN') has, among others, the objective of bringing about the implementation both of treaties and of rules of customary international law,¹² which envisages the responsibility to assist states in implementing rules of international law into their domestic legal systems. Both the Legislative Guide and the Technical Guide are part of this framework: they were designed by the UN to assist countries to achieve compliance with international law, more specifically, the UN Convention Against Corruption. Therefore, in a sense, they are non-binding instruments with significant institutional authority derived by the UN Charter.

Furthermore, certain action plans are also subject of significant consideration in this paper, given its broad international acceptance and compliance by countries. In particular, the Financial Action Task Force ("FATF"), an inter-governmental body within the OECD established in 1989 by the Minister of its Member jurisdictions, is responsible for setting international standards and to promote effective implementation of regulatory, supervisory and operational measures against money-laundering and terrorism financing. The agency has

⁸ The United Nations Office on Drugs and Crime. *Legislative guide for the implementation of the United Nations Convention against Corruption* (New York: United Nations, 2006), vi.

⁹ *Ibid.*, vi.

¹⁰ United Nations Office on Drugs and Crime and United Nations Interregional Crime and Justice Research Institute, *Technical guide to the UN Convention against Corruption* (New York: United Nations, 2009), xviii.

¹¹ Charter of the United Nations and Statute of the International Court of Justice (1945), preamble.

¹² The United Nations. Senior Management Group. *Strategy for an Era of Application of International Law - Action Plan* (2000), 1.

issued the "FATF Forty Recommendations", which consists of a comprehensive and consistent framework of measures that countries must implement into their domestic systems. To illustrate its relevance, the beneficial owner definition issued by FATF is universally accepted by the international community.¹³ This is no surprise, given that the *travaux preparatoire* of the UN Convention Against Corruption affirms that the provision calling State Parties to use the relevant initiatives of international organizations as guideline, should be understood to refer in particular to the Forty Recommendations.¹⁴

Another guiding instrument that has applicability for the purposes of this thesis is the World Bank/UNODC policy paper on beneficial ownership, which provides relevant findings through the analysis of more than 150 major corruption cases across the world, and in the interview of prosecutors, investigators, and compliance officers who closely worked with money-laundering and beneficial ownership information. Furthermore, the Organization for Economic Development and Cooperation ('OECD') has also issues several policy papers on the use of corporate vehicles for illicit activities. All of them provide useful insights on beneficial ownership and its transparency issues through empirical analysis.

Lastly, the evaluation of effectiveness of the international legal instruments discussed in this paper shall be based on the findings of variety of different sources. Academic sources have been considered for two purposes. Firstly, for researching why countries comply with international rules and obligations. Secondly, for analyzing of the current data with regard to the compliance of countries with international regulations of beneficial ownership.

The primary sources for the evaluation of countries compliance and effectiveness with beneficial ownership regulations were (i) the Tax Justice Network Financial Secrecy Index, (ii) Transparency International policy papers, and (iii) the World Bank database of major corruption cases. The Tax Justice Network is a non-governmental organization ("NGO") that focus its research on offshore financial centers that act as tax havens. Its Financial Secrecy Index is a biennial publication that measures the secrecy levels of offshore accounts. Transparency International issued a policy paper reviewing G20 promises on beneficial ownership, evaluating the implementation of beneficial ownership regulation in that group of countries. Finally, World Bank database served to identify which jurisdictions were chosen more often by criminals for the incorporation of companies with information secrecy.

1.2 Delimitations

¹³ Willebois, *The Puppet Masters*, 19.

¹⁴ United Nations Convention Against Corruption (2004), *travaux preparatoire*, 154.

For the core of this thesis, the enforcement aspects of beneficial ownership shall not be discussed. Instead, the focus of this thesis will be the measures aimed at preventing secrecy in beneficial ownership. The reason behind this choice is the sum of two factors. Firstly, this thesis has a limited scope, and is constrained by limitations in length. Accordingly, a more thorough examination of the topic of enforcement is not feasible. Secondly, the preventative perspective deals with the substantive problems of beneficial ownership and its solutions. The enforcement perspective, on the other hand, is limited to ensuring compliance of the preventative framework. Thus, it would seem problematic to discuss enforcement without the understanding the substance of the regulations, which can only be enabled by an examination of prevention perspective.

Moreover, this thesis will not examine the negotiation of international instruments. Rather, this paper will focus on the characteristics and applicability of these instrument. This decision is underpinned by the limited scope of this paper, and the decision to focus on the practical application of instruments - rather than a discussion their formation. Hence, the negotiation of these instruments will only be used as a basis for interpretation of their content and scope.

1.3 Structure

Chapter 2 analyses beneficial ownership and its associated issues. Given the transnational nature of beneficial ownership, it follows that it must be addressed by international, rather than national instruments. Consequently, this chapter focuses upon of its examination on the available international tools and how they may be effectively employed to regulate beneficial ownership secrecy. Chapter 3 reviews the current international rules and obligations applicable for beneficial ownership. It concludes by submitting that, although a comprehensive international legal framework regulating beneficial ownership secrecy is in force, this regime suffers from legitimacy concerns. Lastly, Chapter 4 discusses the current effectiveness of these rules and regulations. It submits that the lack of reciprocity between states, specifically powerful ones, in implementing such rules and regulations results into their low effectiveness.

2 Beneficial Ownership

The "beneficial ownership" concept is not a modern legal creation. Quite the opposite, it traces back to the Crusades' age. Warriors would abstain from England for years and were in need for someone to tend their land. Such person would require full legal capacity to exercise decision powers over the land and collect taxes. Yet, the crusader wanted to secure the recovery of all his rights of ownership upon return from the war. For this reason, the concept of split ownership of the property was created, whereby both the crusader and the person

tending the land were owners of the land. The former by the courts of equity; the latter by the common-law courts.¹⁵

Despite being centuries apart, the beneficial owner concept nowadays is not so distant from the crusaders age. Certainly, it has reshaped into different legal entities structures and legal arrangements, with their respective degrees of complexity, but the idea remains the same: the beneficial owner is not the one who has the administrative - and even legal - power over the 'land'. Instead, the beneficial owner is the one who ultimately holds the control, directly or indirectly, over it. Such control may be secluded from the world for a variety of reasons, including illicit ones.

The lack of beneficial ownership information facilitates illicit activities by three ways. Firstly, by disguising criminals' identity. Secondly, by disguising the true purposes of an account or asset held by the corporate vehicle. Lastly, by disguising the use of assets connected with the corporate vehicle.¹⁶

For example, beneficial ownership information can be obscured through (i) shell companies (complex ownership structure and it is often used cross-boundary), (ii) complex ownership and control structure (multiple layers of ownership and control difficulties tracing the true controller), (iii) bearer shares (shares owned by whoever holds the physical stock certificate), (iv) unrestricted use of legal persons as company's director, (v) nominee directors and shareholders (with the undisclosed identity of the appointee), (v) informal nominee directors and shareholders (when the appointed is a close associate or family), and (vi) trusts and legal arrangements (due to the fact that legal ownership and beneficial ownership can be separate figures).¹⁷

Combined with the use of multiple jurisdictions, these issues are aggravated. Criminals make use of corporate vehicles in different countries, which hinders competent authorities of one jurisdiction to gather all the necessary information of a corporate vehicle for investigation purposes, such as corruption, money laundering or tax evasion.¹⁸

2.1 Is beneficial ownership a problem itself?

¹⁵ Alastair Hudson, *Equity and Trusts*, (London: Cavendish Publishing, 2005), p. 35.

¹⁶ Financial Action Task Force. *Guidance on Transparency and Beneficial Ownership* (Paris: FATF/OECD, 2014), para. 8.

¹⁷ *Ibid.*, para. 9.

¹⁸ *Ibid.*, para. 10.

The use of beneficial ownership for criminal activities poses a substantive issue. The whole concept of beneficial ownership is underpinned by idea of an individual deliberately taking steps to control a legal person or an asset without revealing his or her identity. One may question whether beneficial owner is itself a problem, that is, if persons should be permitted to operate a legal entity or asset under anonymity. The answer to this question involves the human right to privacy,¹⁹ and the public interest to control information in order to prevent and prosecute crimes.

The right to privacy is critical for individual autonomy, dignity and freedom. It provides an indispensable protection against unwanted interference in the personal life of persons against other persons and governments. Such right can also be observed in the commercial sphere, since "privacy is a necessary element for the protection of organizational autonomy, gathering of information and advice, preparations of positions, internal decision-making, inter-organizational negotiations, and timing of disclosure. Privacy is thus not a luxury for organizational life; it is a vital lubricant of the organizational system in free societies."²⁰

On the other hand, access to information is necessary for regulatory bodies and law enforcement agencies to prevent crime. Access to information is often underpinned by new technologies, and constitutes an essential step in terms of investigation and evidence gathering.

Therefore, given their mutual importance, a balance must be struck in order to realize both the right to privacy, and the public interest to prevent and prosecute crimes. In the specific case of beneficial ownership, the middle ground translates into the persons' freedom to control legal entities and legal arrangements while concealing their identity, and the ability of legal authorities to reveal their identity when necessary.

Shell companies can illustrate the modern use and misuse of beneficial ownership, and the necessity of regulating it. Also known as "phantom firms" and "mailbox companies," shell companies do not create products, hire personnel, generate revenue or have any significant business activity.²¹ They are strictly used as a corporate vehicle for another person for different objectives, such as to hold funds temporary while another company is created, or perform a reverse merger publicly. Since it is the shell company information that is used during its activities, instead of the one controlling it, they also serve to hide the owners' identity. This feature makes them especially useful for many purposes, such as to stage a

¹⁹ The Universal Declaration of Human Rights, art. 12.

²⁰ See Alan F. Westin, *Privacy and Freedom* (New York: Atheneum, 1967).

²¹ John Black, Nigar Hashimzade and Gareth Myles Black, *A Dictionary of Economics* (Oxford: Oxford University Press, 2017)

hostile takeover, hide dealings between two companies (when one of the companies has a poor reputation), or for safety reasons (persons in dangerous regions may hide their assets to avoid being targeted by criminals). These are all legal activities, and they illustrate legitimate aspects of identity concealment.

However, shell companies are also used for criminal activities. Due to its ability to hide someone's identity, shell companies present an opportunity for criminals and their illicit activities, such as money-laundering and corruption, which heavily benefits from complete anonymity. Conscious of this risk, most countries have mechanisms in place that, when necessary, allow them to verify the identity of those owning/controlling the shell company, that is, the beneficial owner.

Therefore, *per se*, the existence of shell companies, or any type of legal entities or arrangements that seeks to conceal the identity of the beneficial owners are not a problem. They constitute a legitimate exercise of the right to privacy. Notwithstanding, given their misuse for illicit activities, and the public interest into preventing and prosecuting crimes, beneficial ownership requires mechanisms that allow relevant institutions and competent authorities to acquire their identity in an accurate and timely manner.

2.2 A transnational issue

Beneficial ownership secrecy certainly presents a problem if it is not properly regulated. The transnational nature of beneficial ownership secrecy - with these corporate vehicles often operating across jurisdictions - requires the application of international law.

Virtually, all countries have their financial systems integrated at an international level, and assets can easily circulate from one jurisdiction to another. It is a relatively simple process for someone to incorporate companies into different jurisdictions, as well to open accounts and transfer funds to foreign countries. This integration of financial services poses a problem in terms of the regulatory framework to combat beneficial ownership secrecy. While in one country an extensive list of information may be required to open a bank account or incorporate a company, in another merely superficial information may be required. Thus, whereas countries' financial systems are highly integrated, the same is not true to their regulatory regime. This has severe implications for beneficial ownership, because the lack of this information in one jurisdiction can affect others.²² As the US Secretary of Treasury Larry

²² Martin Gill and Geoff Taylor, "Preventing Money Laundering or Obstructing Business?", *The British Journal of Criminology* 44 (2004): 582, quoting "Precisely because finance is a worldwide pursuit, and because it is easy to transfer funds across the world, any system designed to tackle money laundering needs to have global support."

Summers stated in 2000: "As inter-dependence increases, each country is as vulnerable to financial crime as the weakest link in the chain".²³

Returning to the shell companies' example, they can also demonstrate this point. Shell companies are often incorporated in tax havens, that is, countries where there are few or no taxes for corporations, and, more importantly, the disclosure of banking information is not required by law, or is lower compared to international standards. Criminals exploit this weak regulatory framework of some jurisdictions, since their identity is concealed through shell companies, and there are no means for the competent foreign authorities and institutions to unveil it. Given the financial system integration, assets from these shell companies may freely circulate to other jurisdictions, which can be used for money-laundering or corruption with complete anonymity.

The particular circumstance of having an international integration of financial services, but without a common regulatory framework, gives a transnational nature to beneficial ownership issues. As illustrated, a weaker regulatory framework or even loophole in one jurisdiction can significantly impact all the others. To address this problem, the international community must make use of international law to establish a common regulatory regime, coupled with enforcement mechanisms to ensure its compliance.

2.3 Addressing the problem

Given its transnational nature and negative impacts, beneficial ownership secrecy demands a homogeneous treatment by the international community. Yet, concerning the available international legal instruments, there are a wide range of alternatives to choose from it.²⁴ The question then turns to which of these legal instruments should be employed to achieve the most effective outcome when addressing beneficial ownership secrecy. Before these issues are addressed, however, a brief examination of the available international legal tools is necessary to assist with an evaluation of their application with regards to beneficial ownership issues.

Traditionally, the doctrine divides the normative spectrum of international law between hard-law and soft-law instruments. However, the definition of such terms and their features diverge in the doctrine. Very commonly, positivist legal scholars use the binary binding/non-binding

²³ U.S. Department of the Treasury. "Treasury Secretary Lawrence H. Summers Remarks at the Meeting of the Committee of Hemispheric Financial Issues Cancun" (Office of Public Affairs, 2000), last modified 2 April, 2000, <http://usinfo.org/wf-archive/2000/000203/epf405.htm>.

²⁴ Gregory Saffer and Mark A. Pollack, "Hard vs. Soft Law: Alternatives, Complements, and Antagonists in International Governance Shaffer & Pollack", *Minnesota Law Review* 94 (2010), 717.

to divide hard from soft-law agreements.²⁵ Constructivist scholars, by contrast, prefer to examine law according to their effectiveness, and not based on their binding or non-binding character.²⁶ They argue that the binary view of law is deceptive, since the law varies with regard to its impact on behavior, even in domestic legal systems.²⁷

Others, such as Shaffer & Pollack, and Abbott & Snidal, take a third view that encompasses both positivists and constructivists perspectives. They assert that hard- and soft-law instruments' characteristics vary according to *ex ante* and *ex post* enforcement perspectives.²⁸ The *ex ante* perspective refers to the decision of the regulator regarding which laws to apply to regulate a specific issue. Thus, a regulator may apply either hard- or soft-law instruments when defining permissible behavior. Conversely, the *ex post* perspective refers to the enforcement of a particular law, in the case of a breach. From this perspective, a law is either formally binding, or non-binding.²⁹

Shaffer and Pollack assert that international instruments can be classified along three metrics: (i) precision of rules; (ii) obligation; and (iii) delegation to a third-party decision maker.³⁰

According to this tridimensional theory, instruments would be considered “hard law” when they provide (i) precise rules; (ii) their obligations are binding; and (iii) they delegate authority to interpret and enforce the rules. By contrast, soft law would refer to a residual category, when legal instruments are 'weakened along one or more of the dimensions of obligation, precision, and delegation'.³¹ In this regard, the following affirmation of Shaffer & Pollack is relevant:

Thus, if an agreement is not formally binding, it is soft along one dimension. Similarly, if an agreement is formally binding but its content is vague so that the agreement leaves almost complete discretion to the parties as to its implementation, then the agreement is soft along a second dimension. Finally, if an agreement does not delegate any authority to a third party to monitor its implementation or to interpret and enforce it, then the agreement again can be soft (along a third dimension) [...] ³²

²⁵ *Ibid.*, 712. See also Dinah Shelton, *Commitment and Compliance: the Role of Non-Binding Norms in the International Legal System* (Oxford: Oxford Scholarship Online, 2003).

²⁶ David Trubek et. al., "Soft Law, 'Hard Law' and EU Integration", *Law and New Governance in the EU and the US*, ed, Scott and Burca (Oxford: Oxford University Press, 2006), 65-67.

²⁷ *Ibid.*

²⁸ Shaffer & Pollack, *Hard vs. Soft Law*, 715-716. Kenneth W. Abbott and Duncan Snidal, "Hard and Soft Law in International Governance", *International Organization* 54 (2000), 421.

²⁹ Shaffer & Pollack, *Hard vs. Soft Law*, 716.

³⁰ Shaffer & Pollack, p. 714.

³¹ Abbott & Snidal, 422.

³² Shaffer & Pollack, p. 715.

The conclusion, reached by Shaffer and Pollack - with which this paper concurs - is that both positivists and constructivist scholars have correct assumptions about hard and soft law, which do not necessarily contradict each other if observed through different perspectives.

Furthermore, the doctrine observes that each of these international instruments manifest different advantages. With regard to hard-law instruments, it presents three main features. Firstly, they influence states to commit themselves more firmly to international agreements, either because of legal sanctions or because of reputational costs.³³ Secondly, they can have direct legal effects in domestic jurisdictions, or require legal implementation, which creates new mechanisms that enables the mobilization of public institutions and civil society, hence increasing violation's costs.³⁴ Thirdly, hard-law instruments allow states to monitor and enforce their agreements.³⁵

It is worth noting that the use of hard law is often effective where cooperation is in the interests of nation states and the "potential for opportunism and its costs are high."³⁶ To mitigate such risks of opportunism, countries make use of third-party monitoring, e.g. Trade Policy Review Body and system of committees.³⁷

On the other hand, since hard law can entail significant restriction of sovereignty in sensitive areas, states are more cautious, and negotiations are often more fierce and protracted.³⁸ Consequently, legally binding agreements are harder to adjust to new circumstances.³⁹ On this point, Shaffer & Pollack asserts that "hard law is particularly problematic, where it presupposes a fixed condition when situations of uncertainty demand constant experimentation and adjustment, where it requires uniformity when a tolerance of national diversity is needed, and where it is difficult to change when frequent change may be essential."⁴⁰

As regards to soft law, it offers significant advantages over hard law. Firstly, countries are more likely to negotiate, agree, and cooperate and with less costs, considering that the

³³ Andrew Guzman, "The Design of International Agreements", *The European Journal of International Law* 16 (2005), 579-582.

³⁴ Shaffer & Pollack, *Hard vs. Soft Law*, 718. Abbot & Snidal, *Hard and Soft Law*, 428.

³⁵ Abbott & Snidal, *Hard and Soft Law*, 427.

³⁶ *Ibid.*, 429.

³⁷ Shaffer & Pollack, *Hard vs. Soft Law* 718.

³⁸ Abbot & Snidal, *Hard and Soft Law*, 434.

³⁹ *Ibid.*, 433.

⁴⁰ Shaffer & Pollack, *Hard vs. Soft Law*, 719.

‘sovereignty costs’ are lower, and there are no enforcement risks.⁴¹ Secondly, they are more flexible in terms of uncertainty and adaptation. Thirdly, soft-law instruments are more suitable to diversity. Fourth, they are directly available to non-state actors.⁴²

Yet, rather than to contend hard- and soft-law agreements as exclusive alternatives, they can be observed as complementary tools for the solution of international problems. These instruments can manifest this complimentary nature through two means. Firstly, soft law can lead to the elaboration of hard law. Secondly, hard law can be further elaborated over soft law.⁴³ In the latter case, pertinent to the ex post perspective, "soft law is considered to provide a low-cost and flexible way to elaborate and fill in the gaps that open up when a standing body of hard law encounters new and unforeseen circumstances."⁴⁴

For instance, General Assembly resolutions often function as mechanisms for authoritative interpretation or expansion of the UN Charter. That has been the case with regards to the use of force and decolonization.⁴⁵ Additionally, states employ soft law instruments to provide technical standards and define some rules provided in treaties that require domestic implementation. The soft law used in the environment treaties set the standards of best practice, and due diligence, which State Parties must implement in order to fulfill their binding obligations. As Boyle affirms:

These "ecostandards" are essential in giving hard content to the overly-general and open-textured terms of framework environmental treaties. The advantages of regulating environmental risks in this way are that the detailed rules can easily be changed or strengthened as scientific understanding develops or as political priorities change. Such standards can of course be adopted in binding form, using easily amended annexes to provide flexibility, but this is not always what parties want.⁴⁶

Some treaties go even further, establishing binding force to soft-law instruments by directly or indirectly referencing them within the treaty.⁴⁷ The UN Convention on the law of the sea (1982) extensively employs this practice by indirectly incorporating resolutions and

⁴¹ *Ibid.*

⁴² *Ibid.*, 719.

⁴³ See Jeffrey L. Dunoff et. al., *International Law: Norms, Actors, Process: A Problem-Oriented Approach* (New York: Wolters Kluwer Law & Business. 2006).

⁴⁴ Shaffer & Pollack, *Hard vs. Soft Law*, 722.

⁴⁵ . See "Western Sahara Advisory Opinion", *International Court of Justice* (1975), rep. 12, and "Case Concerning Military and Paramilitary Activities in and Against Nicaragua", *International Court of Justice* (1986), rep. 14.

⁴⁶ Alan E. Boyle. "Some Reflections on the Relationship of Treaties and Soft Law", *International and Comparative Law Quarterly* 48 (1999), 905.

⁴⁷ *Ibid.*, 906.

recommendations of the International Maritime Organization, and by establishing provisions under which states are required or permitted to apply "generally accepted rules and standards established through the competent international organization or general diplomatic conference".⁴⁸

In conclusion, the terminology "hard law" and "soft law" is controversial in the doctrine. Whereas positivists classify them in binding and non-binding categories, constructivists argue that such division is "illusory". However, they can be both correct according to different perspectives: *ex ante* negotiating, and *ex post* enforcement. For the latter perspective, positivists are correct by stating that a legal instrument is either binding or non-binding. For the former, however, the tridimensional theory of legalization serves to illustrate that legal instruments can vary the degree to which they are binding. Hence, both parts of the doctrine have their merits when dealing with different objectives.

Moreover, there are different advantages of the use of hard- and soft-law instruments. Hard-law instruments are more credible, have direct legal effects in domestic legal systems, and entail state responsibility. On the other hand, states have more difficulty agreeing upon binding obligations, and adjustments are harder to make, due to sovereignty costs. Soft-law instruments, on the other hand, are easier to be agreed upon, since there are no sovereignty costs, or enforcement for non-compliance. This makes soft law more flexible for possible adjustments and more suitable to countries' diversities. Additionally, soft law allows the participation of non-state actors. Yet, hard- and soft-law instruments are not exclusive, but can be and are often - adopted jointly. Therefore, in the decision making of the adoption of such instruments, solely or jointly, a series of factors must be accounted for, from their different features to the applied context and actors involved.

2.4 Beneficial ownership: a complementary approach

In the particular case of beneficial ownership, the complementary use of hard- and soft-law agreements may be the best approach. The nature and complexity of the problems arising from beneficial ownership secrecy demand such twofold approach for an effective result.

As explained previously, beneficial ownership issues are transnational and have a significant impact for the international community. The use of anonymous and untraceable control of legal persons and arrangements allows criminals to exploit these structures for illicit purposes,

⁴⁸ United Nations Convention on the Law of Sea (1982), articles 207-212

such as corruption and money-laundering.⁴⁹ To address these problems, both preventative and enforcement dimensions must be addressed.

The preventative dimension is especially important for two reasons. Firstly, the absence of regulatory mechanisms in the concealed control of legal entities and arrangements naturally gives rise to different methods of exploitation of the financial system.⁵⁰ To put it differently, the increase of potential uses of the financial system implies the increase of its potential misuses. Within this rationality, by restricting and controlling the free use of the financial system, a regulatory system also has significant impacts in controlling its illicit exploitation. Secondly, within the criminology domain, it is traditionally understood that the incidence of crimes is lower when the risks of being punished are higher.⁵¹ The higher the risks of being caught, the less comfortable one will be to attempt it. In the case of beneficial ownership secrecy, a preventative regulatory system will reduce the possibilities of its illicit exploitation by enabling the disclosure of such information to the authorities. Additionally, it will also discourage its misuse by potential criminals by increasing the risks of being punished, since those mechanisms will be in force to allow competent authorities to trace beneficial owners.

Regarding the enforcement dimension, it is an important step to ensure compliance at the international and national level. At the former level, compliance of countries through the national implementation of their regulatory obligations. At the latter level, compliance of the national subjects of preventative system (e.g. financial institutions, financial intermediaries, and other bodies).

The use of hard- and soft-law instruments must take into account these two dimensions. It is fundamental that all states have in their jurisdiction mechanisms that permit them to identify beneficial owners. In this regard, a legally binding agreement between countries to create such common regulatory regime that provides for its minimum parameters and mandatory subjects is indispensable. That is because the use of hard-law instruments enables legal enforcement mechanisms to monitor and impose compliance against possible violators. In particular, to combat ‘opportunism’ from jurisdictions that deliberately allow beneficial ownership secrecy - namely, ‘tax havens’ - with the objective to attract capital. For these reasons, the use of legally binding agreements to set out basic obligations to countries is necessary to prevent the misuse of beneficial ownership.

⁴⁹ See World Bank, *The Puppet Masters*, and OECD, *Corporate Veil*.

⁵⁰ Roberto Formisani, "Beneficial Ownership and Effective Transparency", *The New Anti-Money Laundering Law : First Perspectives on the 4th European Union Directive*, ed. Siclari (Rome: Springer International Publishing, 2016), 24.

⁵¹ See Martin Gill & Geoff Taylor, "Preventing Money Laundering or Obstructing Business?", *British Journal of Criminology* 44(4) (2004).

Whereas the binding rules will determine the measures states must undertake to prevent the misuse of anonymous control, they are not "self-executing," but will depend upon domestic implementation. Each country presents specific legal and financial realities, and, consequently, the implementation of the binding obligations will relatively vary. Thus, together with the international legal framework, national regimes will constitute a very relevant part in addressing beneficial ownership problems. In this context, it may be beneficial to employ soft-law instruments in the implementation, because it will allow non-state actors, such as technical international bodies and organizations to participate by assisting countries at addressing their respective idiosyncrasies.

Furthermore, soft-law instruments should be implemented to complement hard-law instruments, due to the dynamic nature of beneficial ownership issues. Indeed, beneficial ownership problems are intrinsically related with the illicit exploitation of the financial system. Since financial systems are in a permanent expansion in terms of capital flow possibilities, there is also, consequently, a constant material increase of ways for it to be misused.⁵² Thus, beneficial ownership issues possess a dynamic nature. To keep up-to-date with the latest problems involving beneficial ownership, flexibility and capacity to evolve to meet new challenges are imperative. Such qualities are found in soft-law instruments. Therefore, soft law should be used when establishing international technical standards for beneficial ownership to prevent its use for criminal activities.

Lastly, given the cross-boundary nature of beneficial ownership issues, information sharing becomes an essential component of the common international preventative system. Countries may require mutual cooperation in order to identify beneficial owners of legal persons or arrangements outside their jurisdiction, for example as part of an investigation. Hence, it may be necessary make international cooperation of beneficial ownership information a legally binding obligation among states and, thus, employ hard-law instruments for this matter.

In conclusion, legally binding instruments should be applied to make countries commitments more credible and to guarantee enforcement and monitoring. Hard law is important to avoid jurisdictional "opportunism," with, for example, "tax havens". To achieve such end, the establishment of a common international preventative system is indispensable. This system should establish a minimum set of measures that allow the identification of beneficial owners by countries, and international cooperation in terms of information sharing. Complementary, non-binding agreements should be used to allow non-state actors to participate in the implementation of the binding obligations in view of states' diversity, and the dynamic nature of beneficial owner issues, which require a faster and more flexible process of amendment.

⁵² Formisani, *Beneficial Ownership*, 24.

3 Beneficial Ownership Addressed by International Law

The different international legal instruments available have been discussed, and their ideal application to beneficial ownership secrecy, but how international law has addressed the issue in practice? When addressing beneficial ownership secrecy, the international community opted for a complementary approach, employing both hard- and soft-law instruments.

The hard law instrument regulating beneficial ownership is the UN Convention Against Corruption (2003), ratified by the vast majority of UN Members States. The Convention covers five main areas of anti-corruption: (i) preventative measures, (ii) criminalization and law enforcement, (iii) international cooperation, asset recovery, and (iv) technical assistance and (v) information exchange. This instrument sets an overall strategy against money-laundering, which combines preventative and enforcement perspectives. The preventative controls, addressed in articles 14 and 52, establish a legal framework divided between regulatory and supervisory powers. These powers are attributed to national public institutions, and those who must comply with it, that is, specific institutions of the private sector.⁵³ Beneficial ownership is a subcomponent of this regulatory regime, more specifically, it falls within the minimum coverage of obligations.

The UNCAC has received criticism for being a "soft" hard-law instrument, with some arguing that it has a binding form with non-mandatory provisions, especially in the criminalization chapter.⁵⁴ It is contended that the use of qualified, imprecise, and non-mandatory language, such as "where appropriate," "shall consider adopting" and "if necessary," or even "in accordance with its domestic system," were designed to allow State Parties to determine the extent to which the Convention will affect their legal systems.⁵⁵ This is also applicable with respect to beneficial ownership, which was inscribed with vague qualification that compromises any attempt of binding countries to the relevant requirements, as it will be further examined.

The reason why so many provisions have a non-binding character or were conditioned to not conflict with existing national laws was grounded on the lack of international consensus, since, being a UN convention, all State Parties of the Charter were able to participate in its development. As Rose notes, "in the case of UNCAC, the effectiveness of its provisions

⁵³ UNODC, *Technical Guide*, 65.

⁵⁴ Cecily Rose, *International Anti-Corruption Norms* (Oxford: Oxford University Press, 2015), 14.

⁵⁵ *Ibid.*, 99.

appears to have been sacrificed for the sake of the instrument's comprehensiveness and global reach."⁵⁶

Moreover, the adoption of complementary soft-law instruments is prescribed by the Convention, in which States Parties are called upon to use as guideline the relevant initiatives of regional, interregional and multilateral organizations against money-laundering in the implementation of the preventative system.⁵⁷ In particular, the use of such soft-law instruments was to be understood as a direct reference to FATF Forty Recommendations,⁵⁸ which is why this paper adopted it as the main source of soft-law regarding beneficial ownership.

Originally drafted in 1990 by the Group of Seven (G-7), as part of an initiative to combat money-laundering in financial institutions by drug trafficking proceeds, the FATF Forty Recommendations were consecutively revised according to new trends and techniques, and it also incorporated other types of money-laundering. In 2001, it expanded to cover terrorism funding. Currently, the Recommendations have been endorsed by over 180 countries, and are universally recognized as the international standard for anti-money laundering/combating the financing of terrorism ("AML/CFT").⁵⁹

The standards set out by FATF comprise the Forty Recommendations and their Interpretive Notes, jointly with the applicable definitions in its Glossary. The measures established by FATF Forty Recommendations are separated into six main categories: (i) identification of risks, development policies and domestic coordination; (ii) tracing money-laundering, terrorism financing, and financing of proliferation of weapons of mass destruction; (iii) preventative measures for the financial sector and other designated sectors; (iv) supervisory power for competent authorities; (v) transparency and beneficial ownership information of legal persons and arrangements; and (vi) international cooperation.

These standards are formally non-binding, as evidenced by the use of the verb "should", instead of 'shall' or "must" in regard to the measures countries must implement. Yet, they are mandatory due to a combination of membership conditions, and sanctions mechanisms accompanying the Recommendations. To become or remain a member, states cannot only use the Recommendations as policy guide, but must implement them as binding law in their domestic legal system. Coupled with that, the organization has effective enforcement

⁵⁶ *Ibid.*, 132.

⁵⁷ UNCAC, articles 14(4) and 52(2).

⁵⁸ UNCAC, *travaux préparatoires*, 154.

⁵⁹ Financial Action Task Force, *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation*, (Paris: FATF, 2012, updated October 2016), 6.

mechanisms, such as a "black list" of countries that pose high risk of money-laundering, or that have been non-cooperative with FATF. With regards to worst offenders, including non-members, the organization has called its members to impose restriction of financial transactions.⁶⁰ Hence, FATF policies are not technically binding, but the effect of their provisions, due to FATF membership and sanctioning structure, is mandatory to members and non-members.

If FATF Recommendations are observed through Shaffer & Pollack tridimensional theory of legalization (precision of rules, obligation, and delegation), it can be said that this instrument is binding in two of its three dimensions. Evidently, concerning the second dimension - obligation - the Recommendations establish obligations that are not formally binding. However, in its first and third dimensions, this instrument it is binding. Its rules are very precise, fiercely reducing Member States discretion when implementing them. Additionally, the Recommendations implicitly delegate authority to interpret and enforce its rules to FATF. Therefore, according to the tridimensional theory, it could be said that FATF Recommendations are more binding than non-binding.

On the other hand, applying Shaffer & Pollack's legalization theory to UNCAC, the conclusions are quite the opposite concerning the first and second dimensions. The Convention establishes obligations that are formally binding (second dimension), but they lack precision (first dimension). The authority to interpret and enforce them is delegated to the International Court of Justice (third dimension).⁶¹ Hence, under this legalization theory, UNCAC is also more binding than non-binding.

Notwithstanding, it would be incorrect to conclude that both UNCAC and FATF Recommendations are in the same level of "legalization". Certainly, both fulfill two dimensions out of three in what is defined as "hard law" by the tridimensional theory. However, these two fulfilled dimensions should not be seen as having the same weight. That is because the lack of precision of a rule (first dimension), can undermine its constraining force, and, consequently, the existing enforcement mechanisms (third dimension). For instance, both UNCAC and FATF Recommendations have enforcement mechanism in place, independently of whether their obligations are formally binding or not. Yet, the vague and qualified rules of the UNCAC broader their interpretation, giving more discretion to states on how to implement them. Consequently, the enforcement of the Convention is more limited.

⁶⁰ Rose, *International*, 178.

⁶¹ UNCAC, art. 66(2).

Additionally, it is worth noting that State Parties to the UNCAC can make reservations towards the provisions they disagree over, including the ones dealing with enforcement mechanisms, whereas FATF Forty Recommendations does not allow such feature.

The overview of the current international instruments in regard to beneficial ownership is curious - to say the least - where the hard-law instruments are "soft", and the hard-law instrument are "hard". Yet, this fact appears to be intrinsically connected with the legitimacy of these instruments. The UNCAC is non-mandatory, because states negotiated obligations with very permissive language, and a large scope of discretionary power. This is attributed to the universal participation in the negotiations, which it made difficult to achieve consensus over the Convention's obligations. The FATF Recommendations are mandatory, with precise and strict obligations, exactly because it was drafted by but certain developing and developed countries (the Group of Seven), and heavily enforced against those who fail to comply with, including non-members.⁶² It is worth noting that FATF's membership policy limits membership to states that have strategic economic or geographic importance. Consequently, the participation in FATF's policy development is restricted to certain developing and developed countries.⁶³ The result is an inverse correlation of such international instruments in terms of legitimacy and mandatory obligations. The UNCAC is non-mandatory, but its development had universal participation; the FATF Recommendations is mandatory, but it was created by a few developed countries.

Lastly, coupled with legitimacy issues, the sanctions surrounding FATF Recommendations appears to be inconsistent with international law. This stems from the fact that the Recommendations are not international legal obligations. Accordingly, its enforcement measures would not meet the definition of countermeasures, which requires, among other elements, the involvement of an international legal obligation.⁶⁴ Hence, when FATF impose sanctions against non-member states, for example by restricting financial transactions with those considered "havens" for money-laundering through the concealment of beneficial ownership information, these acts characterize, instead, acts of retorsion, an unfriendly conduct and inconsistent with general international obligations.⁶⁵

This chapter will address beneficial ownership and its issues through descriptive analysis of the current international instruments, their interpretation and interaction. It discuss the

⁶² Rose, *International*, 58.

⁶³ FATF, 'Annual Report 2007-2008' (2008), Annex 5, Step 1. See also FATF, 'FATF Membership Policy', retrieved from <http://www.fatf-gafi.org/about/membersandobservers/fatfmembershippolicy.html>.

⁶⁴ Rose, *International*, 59.

⁶⁵ James Crawford, *The International Law Commission's Articles on State Responsibility: Introduction, Text and Commentaries* (Cambridge: Cambridge University Press, 2001) 281, para 1.

following topics. Firstly, the establishment of an international preventative system to avoid the concealment of beneficial owners, which includes the (i) system's scope, (i) subjects, (iii) minimum coverage of obligations, (iii) accessibility of beneficial ownership information by national and international competent authorities, and (iv) enforcement. Secondly, the development of a harmonized legal definition of beneficial ownership.

3.1 Establishing an International Preventative System

In order to avoid the exploitation of corporate vehicles for illicit activities, such as money-laundering and corruption, the identity of beneficial owners must be available, or at least mechanisms should be in place that would allow their identification. To achieve such end, the UNCAC binds States Parties to institute a regulatory and supervisory framework in their respective legal systems. When establishing this legal framework, countries must observe specific components prescribed by the Convention, under article 14. It read as follows:

1. Each State Party shall:

(a) Institute a comprehensive domestic regulatory and supervisory regime for banks and non-bank financial institutions, including natural or legal persons that provide formal or informal services for the transmission of money or value and, where appropriate, other bodies particularly susceptible to money-laundering, within its competence, in order to deter and detect all forms of money-laundering, which regime shall emphasize requirements for customer and, where appropriate, beneficial owner identification, record-keeping and the reporting of suspicious transactions. (emphasis added)

Before the specific components are addressed, it necessary to highlight that article 14 commands countries to implement a "comprehensive" preventative "regime". This qualified term - "comprehensive regime" - is rather vague, demanding further interpretation.

In international law, interpretation is deeply rooted in the use of the VCLT, in particular articles 31 and 32.⁶⁶ As Bianchi noted, "the VCLT almost invariably appears in any argument concerning the interpretation of a text in international law".⁶⁷ This would not be a surprising fact, considering that the VCLT sets the only admissible interpretational rules of international law.⁶⁸ Therefore, given that UNCAC is international law, article 14 and its terms must be interpreted accordingly.

⁶⁶ Christian Djeflal, "Interpretation in International Law", *European Journal of International Law*, ed. Bianchi, Peat and Windson 28(2) (2017) 46.

⁶⁷ *Ibid.*, 45.

⁶⁸ The United Nations. *Yearbook of the International Law Commission* 1966 Vol. II (New York: UN, 1967), 225.

Article 31 of VCLT provides that a "treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose".⁶⁹ This interpretation rule, nowadays customary international law,⁷⁰ establishes a literal interpretation of provisions, in their context, as a starting point. However, it seems that the objective interpretation of the term "comprehensive regime" is rather redundant.

By separating the term "comprehensive regime", "comprehensive" initially remotes to "including or dealing with all or nearly all elements or aspects of something".⁷¹ As to the word "regime", in French law it denotes a system of rules or regulations.⁷² The redundancy found to this case is due to the fact that a system, per se, includes or deals with all elements surrounding it. Because every system is comprehensive, so it is a regime by definition. For example, a legal system is defined as a jurisdiction's basis of creating and applying a law considering all existing laws, and their hierarchical order.⁷³ Thus, a legal system has to be comprehensive. Therefore, in the same way it would be redundant to say "comprehensive legal system," so it would be "comprehensive regime".

Yet, applied in the context of domestic implementation of international rules, which article 14 of the Convention falls within, the words "comprehensive regime" envisages another connotation. Indeed, this provision establishes the duty of State Parties to implement certain preventative measures in their domestic legal systems. This obligation to implement is observed by the provision's title "measures to prevent money-laundering", combined by the provision's command "State Parties shall institute", and by further prescribing specific obligations to them.

In this national implementation context, the term 'comprehensive regime' can be understood as "adjustable regime", incorporated by the Convention to address the problem of one common preventative system to the very different legal and financial realities each country faces. It would not be effective or feasible for the application of the same preventative measures to distinct jurisdictions. Hence, whereas the Convention requires States Parties to institute a preventative system against money-laundering, composed of specific mandatory components, the implementation of such components will vary according to each State Party.

⁶⁹ Vienna Convention on the Law of Treaties, art. 31.

⁷⁰ "Libyan Arab Jamahiriya v. Chad". *International Court of Justice* (1994) para. 41; "Iran v United States of America", *International Court of Justice* (2003) para. 23.

⁷¹ Oxford Dictionaries, s.v. "comprehensive," accessed 2 February, 2018, <https://en.oxforddictionaries.com/definition/comprehensive>

⁷² Black's Law Dictionary Online Legal Dictionary, s.v. "regime", accessed 2 February, 2018, <https://thelawdictionary.org/regime/>

⁷³ Black's Law Dictionary, s.v. "legal system".

Different models can be incorporated according to each country's specific circumstances, such as financial system size, national's economy, and legal system. Supporting this interpretation is the UN Technical Guide to the UN Convention Against Corruption, which states that "as long as the designed system covers both regulatory and supervisory aspects, States Parties are free to establish the system that best fits their circumstances in view of the requirements and complexity of implementing such a system".⁷⁴

For instance, among the different models a State Party may implement, the competent body responsible for the regulatory and supervisory regime may vary according different degrees of autonomy and power. It is possible for the responsibility to be attributed to an already existing government body, such as the Ministry of Finance, or to be create a specific agency to exclusively handle it. Indeed, it is very common among countries to have a specialized financial intelligence unit ("FIU") with exclusive competence for money-laundering matters, gathering and analyzing reports from financial and non-financial institutions. The FIU can be purely administrative, or hold enforcement powers. It can be completely independent, or under control of another body, e.g. Ministry of Finance or a Central Bank.⁷⁵

Another model of preventative system that countries can adopt is by establishing a self-regulatory regime. In this model, part of the regulatory and supervisory functions are transferred to private institutions. Business associations or professional associations perform the regulatory role, and public bodies merely supervise it. Some variations of such model include vesting these private institutions with enforcement powers. Evidently, such model relies on the good faith of the private sector to self-regulate. Based on this conclusion, this model is more compatible with States Parties that present a low percentage of domestic economic crimes, compared to a high exploitation of their financial system.⁷⁶ The successfulness of this model is based on the fact the trustworthy financial private sector has a special interest to avoid such illicit transactions, since its reputation affects its business performance.

In conclusion, "comprehensive" preventative system is to be understood in both its discretionary and prescriptive definitions. On one hand, it allows State Parties choose between different models of preventative systems. On the other hand, it imposes on them the obligation to assess which of these models is more suitable to their respective domestic legal system, and economic realities and risks to money-laundering.

⁷⁴ UNODC, *Technical Guide*, 65.

⁷⁵ *Ibid.*, 67.

⁷⁶ *Ibid.*, 67-68.

Having addressed the term "comprehensive regime", article 14 prescribes specific components of a regulatory and supervisory regime, which can be divided in three categories, according to their (i) scope, (ii) subjects, and (iii) minimum obligations coverage.

3.1.1 Scope

The system's scope should be the prevention of crimes. Several studies have explored the misuse of corporate vehicles for the commitment of crimes, and how the identification of those controlling these corporate vehicles is a crucial measure to prevent crimes.⁷⁷ Hence, the regulation of beneficial owners should be a part of the overall preventative system, but it not its objective.

Under the current international law, the preventative legal regime was not instituted to prevent all forms of crimes, but specifically 'in order to deter and detect all forms of money-laundering'.⁷⁸ Unfortunately, this may result in further issues, considering that beneficial ownership can be used for illicit activities other than money-laundering, such as payment of bribes, fraud, and even evading international sanctions.⁷⁹ However, it is also understandable that the UNCAC was specifically developed to combat corruption, and its scope is thus limited to it. Yet, UNCAC leaves a loophole, which should be addressed, either by enacting other hard-law instruments to expand the scope of the preventative system, or by amending UNCAC, in order to acknowledge other purposes of beneficial ownership exploitation than money-laundering.

Furthermore, both the United Nations Office on Drugs and Crime ("UNODC") and the United Nations Interregional Crime and Justice Research Institute ("UNICRI") argue that the Convention implies effectiveness as part of the interpretation of preventative system's scope.⁸⁰ The UN bodies lists three requirements in order for the preventative system achieve its objective effectively. Firstly, financial and non-financial institutions take measures to prevent the use of their systems for money-laundering, including customer due diligence ("CDD"), monitor activity and to report suspicious actions (further explained in the following sections). Secondly, information gathered from financial institutions and agencies must be gathered, and shared with other domestic and international authorities, as well be analyzed for enforcement action. Lastly, laundering allegations must be investigated and prosecuted.⁸¹

⁷⁷ See Financial Action Task Force, *The Misuse of Corporate Vehicles, Including Trust and Company Service Providers* (Paris: FATF, 2006), Financial Action Task Force, *Money Laundering Using Trust and Company Service Providers* (FATF: Paris, 2010), and World Bank, *The Puppet Masters*.

⁷⁸ UNCAC, art 14.

⁷⁹ ICJI, *Papana Papers*.

⁸⁰ UNODC, *Technical Guide*, 66.

⁸¹ *Ibid.*, 66.

3.1.2 Subjects

There are questions regarding which persons should be subjected to the regulatory framework. One alternative would be to subject all legal persons and arrangements to provide beneficial ownership information of its customers. Although this would be the best alternative in transparency terms, it would certainly impede the movement of legitimate capital, prohibited under article 14(2) of UNCAC, and it would not be cost effective. For this reason, the best approach would be through the use of risk assessment tools to assess different sectors of their economy and, based on their respective risk levels to money-laundering, decide which legal person should be subject to the preventative regime.⁸²

Certainly, money-laundering and corruption can occur in any commercial activity. However, based on a number of case studies, it is possible to observe that specific economic sectors are more prone to it. These economic sectors, that naturally present higher risk,⁸³ should be incorporated as mandatory subjects of the regulatory regime of all countries. Needless to say, this is the case of financial institutions and financial intermediaries.⁸⁴ However, there are some non-financial activities that should also be considered mandatory subjects, given their high-risk. That is the case of extractive industries,⁸⁵ and real-estate.⁸⁶ Additionally, lawyers providing financial services should also be subject to the regulatory regime. According to an OECD report, based on the analysis of more than 400 cases of corruption, lawyers were involved in 6% of them.⁸⁷ Lawyers present high-risk of corruption and money-laundering due to the client-attorney privilege that conceals the beneficial owner's identity.

While UNCAC adopted such approach in the determination of the regime's subjects, it seems to have failed to cover all the necessary mandatory subjects. Article 14 provides that the subjects of the preventative regime are financial institutions, financial intermediaries, and 'other bodies particularly susceptible to money-laundering'. The Interpretation of the provision with regard to financial institutions and intermediaries is clear: they are mandatory subjects of the regulatory regime. As explained above, that is due to the natural high risk their

⁸² *Ibid.*, 68.

⁸³ UNODC, *Legislative Guide*, paras. 140-143.

⁸⁴ See Basle Committee on Banking Supervision, *Prevention of Criminal Use of the Banking System for the Purpose of Money-laundering* (BIS: 1988).

⁸⁵ Financial Action Task Force, *Specific Risk Factors in Laundering the Proceeds of Corruption Assistance to Reporting Institutions* (Paris: FATF, 2012), 15.

⁸⁶ See Financial Action Task Force, *Money Laundering & Terrorist Financial Through the Real State Sector* (Paris: FATF, 2007).

⁸⁷ Organization for Economic Cooperation and Development, *OECD Foreign Bribery Report : an Analysis of the Crime of Bribery of Foreign Public Officials* (OECD, 2014), 29.

activities present for the incorporation of proceeds of crimes into the financial system. However, with regard to non-financial subjects, article 14 does not establish mandatory subjects. Instead, it provides that countries must subject "other bodies" to the regulatory regime based on their susceptibility for misuse for money-laundering. Yet, the Convention does not provide any detail on how such "susceptibility" is to be measured. Hence, due to the lack of precision, UNCAC has a "soft" provision with respect to non-financial bodies.

This is of specific concern given that nowadays activities outside the financial domain pose a significant threat to the concealment of beneficial ownership information for illicit activities. For instance, the "Panama Papers" involved a law firm providing corporate service exploiting client-attorney privilege to conceal beneficial owner's identification.⁸⁸

In conclusion, by not envisaging all its necessary subjects, UNCAC significantly weakens the preventative system effectiveness.

FATF Recommendations, in the other hand, cover specific non-financial persons as mandatory subjects of the regulatory regime. The Recommendations provide that, besides financial institutions and intermediaries, designated non-financial business and professions ("DNFBPs") must be subjected to the regulatory framework, when providing certain services. They are (i) casinos, when customers engage in high amounts, (ii) real-estate agents, when representing clients in the buy or sell of real estate, (iii) dealers in precious metals or stones, when involving high amounts, (iv) lawyers and accountants, when they carry out financial services for their customers.⁸⁹ As an example of "other bodies," commonly some jurisdictions extend regulatory obligations to commercial activity involving high-value goods, such as art industry, gemstones, and even car selling.⁹⁰

3.1.3 Minimum obligations coverage

Having established which persons should be the subject of the regulatory regime, the next step is to address the minimum coverage of obligations necessary to avoid the exploitation of beneficial ownership. In this particular, the UNCAC provides that the regulatory regime must establish "requirements for customer and, where appropriate, beneficial owner identification, record-keeping and the reporting of suspicious transactions".

⁸⁸ ICJI, *Panama Papers*.

⁸⁹ FATF, *Recommendations*, n. 22. In addition, the UNCAC *travaux préparatoires*, 54, indicates that the words 'other bodies' were to be understood to include intermediaries, which in some jurisdictions may include stockbroking firms, other securities dealers, currency exchange bureau or currency brokers.

⁹⁰ UNODC, *Technical Guide*, 68.

3.1.3.1.1 Beneficial Ownership Information

As observed under article 14, the Convention establishes beneficial ownership information as part of an overall customer due diligence. Yet, beneficial owner identification is not to be performed in every due diligence, but only "where necessary". In the context of customer due diligence, pursuant UNODC, "where necessary" is to be understood to mean when there are reasons to believe that another person holds an interest or control over the persons' ownership and transactions.⁹¹ The problem arises as to which conditions should be met in order to enliven this provision.

As previously mentioned, the UNCAC has many non-mandatory provisions, and beneficial ownership is no exception. The use of imprecise terminology can be seen to manifest State Parties intention to control the extent to which the Convention would impact their legal systems.

That said, despite the fact that none of the present soft-law instruments provide guidance on this matter, or take a different approach to the matter,⁹² the solution may be connected with the *know-your-customer* principle of prudential banking law.⁹³ In essence, service providers that fall within the regulatory framework must act as "gatekeepers" to stop values derived from illicit activities from being incorporated into the financial system. This principle is further outlined in Article 52 of the Convention, which deals with financial institutions and their obligation to identify and verify customers' identity.

The evaluation of the circumstances in which beneficial owner identification is necessary would be performed through the mentioned customer assessment. It would require a case-by-case examination, with profiling mechanisms that take into account the customer's business complexity and risk. Once it has been assessed that the business meets a certain risk level, beneficial owner identification would be necessary. Example of some factors that would trigger the requirement of beneficial ownership information are values disproportionate to the person's financial activity, or when power of attorney is conferred to someone who is not closely linked to the account holder.⁹⁴ Lastly, a periodic review of business activity would be essential to evaluate potential new beneficial owners.⁹⁵

⁹¹ *Ibid.*, 69.

⁹² FATF, *Recommendations*, rec. 10, places beneficial owner information as part of the general.

⁹³ UNODC, *Technical Guide*, 69.

⁹⁴ *Ibid.*, 196.

⁹⁵ *Ibid.*, 69.

The problem about this conditional approach to beneficial ownership, in which State Parties will decide "where appropriate", is that it still leaves a large margin of discretion to states, which is exactly what the Convention should stand against. "Safe Havens", and jurisdictions allowing beneficial ownership secrecy are the main issues surrounding the misuse of corporate vehicles.⁹⁶ In order to prevent new "Panama Papers", UNCAC's scope should bind states to the precise obligation to identify beneficial owners, not allow states to simply "opt out" for opportunism or to cut costs.

By contrast, FATF Forty Recommendations presents another approach to the requirement of financial institutions to identify beneficial owners, in which beneficial ownership information should be part of the overall customer due diligence ("CDD") of financial institutions, and not only "where necessary".⁹⁷ Not only financial institutions must perform beneficial ownership due diligence, but also DNFBPs.⁹⁸ Considering the de facto binding nature of the Recommendations, states are, thus, required to require beneficial ownership information as part of the regulatory framework for gatekeepers.

Moreover, article 52 of the UNCAC institutes important additional obligations for financial institutions, which can be seen as a response to the high risk these institutions present, especially for money-laundering. As concluded by the World Bank/UNODC, "the laundering of the proceeds of corruption is virtually impossible without making use of the services provided by banks". In order to exploit the financial sector, corporate vehicles are used to conceal criminals' identity. Therefore, financial institutions are indispensable "gate-keepers" and are required to play a bigger role in the preventative system. With that in mind, article 52 provides that:

1. Without prejudice to article 14 of this Convention, each State Party shall take such measures as may be necessary, in accordance with its domestic law, to require financial institutions within its jurisdiction to verify the identity of customers, to take reasonable steps to determine the identity of beneficial owners of funds deposited into high-value accounts and to conduct enhanced scrutiny of accounts sought or maintained by or on behalf of individuals who are, or have been, entrusted with prominent public functions and their family members and close associates. Such enhanced scrutiny shall be reasonably designed to detect suspicious transactions for the purpose of reporting to competent authorities and should not be so construed as to discourage or prohibit financial institutions from doing business with any legitimate customer.

⁹⁶ See OECD, *Misuse of Corporate Vehicles*.

⁹⁷ FATF, *Recommendations*, rec. n.10.

⁹⁸ *Ibid.*, rec. 22.

The above article obligates financial institutions to identify and verify the identity of beneficial owners when there are "funds deposited into high-value accounts". During the *travaux préparatoires*, some delegations expressed concern that the meaning of "high-value account" should be clarified with an amount or to allow for relative differences in economies.⁹⁹ Given that the Convention did not specify any quantity threshold that would constitute a "high-value account", the definition of this term was left to the discretion of state parties. Therefore, the Convention assigned to each country's discretionary competence the role of establishing the minimum amount that constitutes a "high-value accounts".¹⁰⁰

When determining the threshold of a "highly valued account", the Technical Guide recommends State Parties to consider applying it not only to bank accounts, but also to other accounts that are susceptible to money-laundering, e.g. securities accounts and management agreements for deposits made by third parties. Financial services, offshore entities, discretionary trusts, and professional persons (client-attorney privilege) presenting higher money-laundering risk, thus, warranting higher beneficial ownership scrutiny from countries.¹⁰¹

Moreover, still within the "high-valued accounts" context, the UNCAC establishes that financial institutions must "verify" the identity of customers, an additional requirement in comparison with the less stringent "identify" obligation provided in article 14. The term "verify" is to be understood a duty to double-check information provided by customers, and not simply receive them as a formal procedure.¹⁰² Likewise, financial institutions are required to "take reasonable steps to determine the identity of beneficial owners".¹⁰³ The Convention does not further elaborates on the meaning of "reasonable steps", which could be attributed to an intention to give freedom of choice to each State Party according to its particularities.

Yet, the term "reasonable steps" must be interpreted in accordance with FATF Forty Recommendations. Under Article 52(2) of the Convention, States Parties should make use of international bodies guidelines in the implementation of the measures established in the Convention. The Convention's *travaux préparatoire* provides that such reference to international bodies' guidelines was to be understood as a specific reference to FATF Forty Recommendations.¹⁰⁴

⁹⁹ UNCAC, *travaux préparatoires*, 446 and 449.

¹⁰⁰ UNODC, *Legislative Guide*, para. 687.

¹⁰¹ UNODC, *Technical Guide*, p. 195.

¹⁰² *Ibid.*, 194.

¹⁰³ UNCAC, art. 52.

¹⁰⁴ UNODC, *travaux préparatoire*, 154.

That said, according to the Recommendations, "reasonable measures" refers to the obligation to verify the identity of beneficial owner means, which implies that financial institutions must understand the customer's ownership and control structure, and use of reliable independent source documents in this verification process. Financial institutions must be sufficiently certain regarding who the beneficial owner of a corporate vehicle is.¹⁰⁵ Additionally, financial institutions must perform continuous due diligence through the business relationship to ensure the information is consistent.¹⁰⁶

3.1.3.1.2 Record-Keeping

While the gathering of beneficial ownership information is an important component of the preventative system, the aspects surrounding the storage of such data is essential, especially in factum aspects, where investigations use such records to follow the trail of money, and as evidence for prosecutions.

For this matter, UNCAC binds State Parties to require gatekeepers to keep record of their customers' information, but it is silent what details should be recorded. Hence, it falls to the discretion each State Party to decide the time-frame for keeping such records, the adopted format, as well which information are to be considered a "record" for the purposes of article 14.¹⁰⁷ Considering the relevancy of beneficial ownership information, it certainly falls within the meaning of "record", and is thereby required to be kept.¹⁰⁸

Regarding record-keeping, FATF Recommendations establish that financial institutions must maintain for at least five years after the date on which the company ceased to exist, or after the date on which the commercial relation between the company and the financial intermediary ceased, "all necessary records on transactions, both domestic and international, to enable them to comply swiftly with information requests from the competent authorities".¹⁰⁹

3.1.3.1.3 Duty to Report

Lastly, the duty of gatekeepers to report any suspicious transactions to public authorities is fundamental for an effective preventative system. Without it, enforcement would be severely

¹⁰⁵ FATF, *Recommendations*, rec. 10(a)(b).

¹⁰⁶ FATF, *Recommendations*, rec. 10(d).

¹⁰⁷ UNODC, *Technical Guide*, 69.

¹⁰⁸ UNCAC, art. 52(3).

¹⁰⁹ FATF, *Recommendations*, rec.11.

compromised. With that in mind, article 12 of the UNCAC requires gate-keepers to report "suspicious transactions".

The definition of what constitutes a "suspicious transactions" is left to State Parties to determine, given that the Convention opted to not to define this term. With the aim of assisting countries on this matter, the UNODC/UNICRI affirm that states can base their definition of "suspicious transaction" in either an objective or subjective approach.¹¹⁰ The former is based on quantity thresholds, and the reports are sent to competent agencies that analyze the information. The latter is based on the gatekeepers' discretion, that is, its own assessment of which transactions or other actions are considered "suspicious".¹¹¹ Notably, virtually all State Parties believe the latter is more effective, as they concluded that the gatekeepers are in the best position to decide.¹¹² Lastly, in the process of implementing one of the systems, or even both together, the international bodies recommend that countries should strike a balance between gatekeepers' margin of discretion, and the public agencies capability to process information.¹¹³

3.1.3.1.4 Access to Information by national and international competent authorities

In order for the competent authorities to prevent the misuse of corporate vehicles, it is imperative that they have sufficient access to beneficial ownership information. The use of multi-jurisdictional structures by criminals poses a serious transnational problem that demands international cooperation, in particular with regards to information sharing. To achieve such end, fundamental aspects must be addressed, such as centralization, precision, and a reasonable time-frame when receiving the information.

In this regard, UNCAC establishes that State Parties "shall consider" instituting a financial intelligence unit ("FIU"), to serve as a national center responsible for receiving, analyzing and disseminating report of suspicious financial transactions to the competent authorities, and cooperate in the information exchange at the national and international levels.¹¹⁴ Hence, the Convention fails to establish an essential component in the adequate access to information by not binding states to create FIUs, which would centralize, analyze and disseminate beneficial ownership information.

¹¹⁰ UNODC, *Technical Guide*, 70.

¹¹¹ *Ibid.*, 70.

¹¹² *Ibid.*

¹¹³ *Ibid.*, 70.

¹¹⁴ UNCAC, arts. 14(b) and 58

By contrast, the FATF Recommendations commands Member States to enable mechanisms that allow access to beneficial ownership information in "a timely and accurate manner" by competent authorities.¹¹⁵ The term "timely" is not further detailed. However, taking into account the purposes of the access of information by competent authorities - investigate and prosecute crimes -, the word "timely" should be interpreted to mean within the time-frame in which the pursuit of such purposes are not compromised. This condition is of special importance in transnational investigations, which demands the participation of authorities from different jurisdiction, with different sizes and available personnel.

Furthermore, the FATF Recommendations maintain a broader approach to the systematization of beneficial ownership information, in comparison to UNCAC. Whereas the latter focus exclusively in the gathering of information through gatekeepers and its centralization using FIU, the former encompasses the potential use of national company registries.¹¹⁶

According to the Recommendations, beneficial ownership information can be made accessible by either two ways. Either by the company itself is to provide the information, and make it available in a specific location in their country (i.e. company registry or in the company headquarters), or the state to enact legal mechanisms that enable the competent authorities to determine beneficial ownership information in a timely manner.¹¹⁷ With regard to the second method, Interpretive Notes by FATF provide the following specific mechanisms, one or more of which must be adopted by states:

(c) Using existing information, including: (i) information obtained by financial institutions and/or DNFBPs, in accordance with Recommendations 10 and 22 (45); (ii) information held by other competent authorities on the legal and beneficial ownership of companies (e.g. company registries, tax authorities or financial or other regulators); (iii) information held by the company as required above in Section A; and (iv) available information on companies listed on a stock exchange, where disclosure requirements (either by stock exchange rules or through law or enforceable means) impose requirements to ensure adequate transparency of beneficial ownership.

Footnote 45: Countries should be able to determine in a timely manner whether a company has an account with a financial institution within the country.¹¹⁸

¹¹⁵ FATF, *Recommendations*, recs. 24 and 25.

¹¹⁶ FATF, *Recommendations*, p. 86.

¹¹⁷ *Ibid.*, 85.

¹¹⁸ *Ibid.*, 85.

In addition to the above, FATF Recommendations provides that states must ensure full cooperation from companies in determining the beneficial owner(s), which specifically includes:

(a) Requiring that one or more natural persons resident in the country is authorized by the company (46), and accountable to competent authorities, for providing all basic information and available beneficial ownership information, and giving further assistance to the authorities; and/or

(b) Requiring that a DNFBP in the country is authorized by the company, and accountable to competent authorities, for providing all basic information and available beneficial ownership information, and giving further assistance to the authorities; and/or

(c) Other comparable measures, specifically identified by the country, which can effectively ensure cooperation.

Footnote 46: Members of the company's board or senior management may not require specific authorization by the company.¹¹⁹

In the event of the beneficial owner identity not being determined after all the available measures were exhausted, financial institutions must obtain and keep the identity of the relevant natural person in the seniority management position.¹²⁰

In relation to international communication of beneficial ownership information, the Recommendations obliges countries to provide for a rapid, constructive, and effective international cooperation. Specific measures to be taken are (a) access by foreign authorities to basic information held by company registries, (b) shareholder's information exchange, and (c) assist their foreign counterparts to obtain beneficial ownership information, according to their domestic legal system.¹²¹

3.1.3.1.5 Enforcement

With regards to enforcement of the regulatory framework, UNCAC and the FATF Recommendation are very similar. They repeat the same expressions, and both have mandatory character. As previously explained, the enforcement perspective of the preventative system will not be addressed in detail.

¹¹⁹ Ibid., 86.

¹²⁰ Ibid., Interpretive Note to rec. 10, para. 5(b)(i).

¹²¹ Ibid., 88.

UNCAC, under article 26(4), states that each State Party must ensure legal persons are liable for effective, proportionate and dissuasive criminal or non-criminal sanctions, including monetary sanctions. The FATF Recommendations provide similar terms for enforcement of the regulatory regime, but extend the liability to natural persons as well.¹²²

3.2 Harmonized Definition of Beneficial Owner

The effective implementation of a preventative system against illicit activities through the misuse of corporate vehicles requires a unified legal definition of beneficial owner. Lack of unification could result in fragmentation of regulatory obligations at the international level. That is because different definitions of beneficial ownership by countries would result in the gathering of different information. In addition, beneficial ownership information in some jurisdictions could be inadequate or inaccurate. Therefore, fragmentation of the definition beneficial ownership information could severely hinder the prospect of a common preventative system.

That said, the UNCAC does not provide a definition for beneficial owner. Rather, the definition is found in the glossary of FATF Forty Recommendations. There are two main possibilities why UNCAC did not address the definition of beneficial ownership. Firstly, due to the dynamic nature of beneficial ownership secrecy, explained previously, the legal instruments regulating the details of it, including its definition, may require regular updates. For this reason, soft-law instruments, with an easier amendment process, like FATF Recommendations, are a better choice than hard-law instruments. Secondly, the negotiation of binding provision of the UNCAC already proved to be difficult, as states could not find a consensus. To achieve consensus on specific aspects of its provisions, such as beneficial ownership, would, thus, be even more complicated. FATF Recommendations, on the other hand, are elaborated by a small group of countries, with relatively similar interests, which it makes achieving consensus easier. In any event, the internationally endorsed definition of beneficial owner reads as follows:

Beneficial owner refers to the natural person(s) who ultimately owns or controls a customer and/or the natural person on whose behalf a transaction is being conducted. It also includes those persons who exercise ultimate effective control over a legal person or arrangement.¹²³

Before further considerations are discussed, it is worth noticing that the above definition was created under the regulatory context of *know-your-client* of financial institutions, which

¹²² Ibid., 87.

¹²³ Ibid., 15.

explains why the terms "customer" and "transaction" were adopted. That said, the term "customer" accepts both the possibilities of being a legal or a natural person.¹²⁴

3.2.1 Key Components

The FATF definition of beneficial owner comprises a number of key elements that, for its full understanding, must be individually examined. Firstly, this paper will discuss its core element (ultimate control). Thereafter, the derivatives of this element (natural persons and beneficial ownership) will be examined. Finally, beneficial ownership is not restricted to legal persons, but encompasses also transactions, and legal arrangements.

3.2.1.1 *Ultimate Control*

The first and most decisive element of the beneficial owner concept is ultimate control. According to the World Bank, in the majority of the large corruption cases, corporate vehicles were exploited due to their corporate opacity to masquerade the individual's identity and, thus, facilitate illicit activities.¹²⁵ The "ultimate control" component is utilized as a mean to pierce such opacity and reveal the person who de facto "pulling the strings".

Initially, the idea of ultimate control is relatively straightforward: it involves determining who is at the end of the control chain. In practice, however, the assessment of who has the final control is rather difficult. Each legal entity presents its own corporate structure, with its respective power configuration, turning the identification of the beneficial owner into an exercise in analyzing different systems of corporate governance. Yet, traditional corporate governance structures may sometimes not be sufficient to identify the beneficial owner, as other unusual legal instruments can affect the chain of control of a legal entity or arrangement. Additionally, in some cases it may occur that the threshold for what constitutes "ultimate control" is not met. For these reasons, identifying the beneficial owner is not always a simple task, instead one must undertake a case-by-case analysis of each legal entity and legal arrangement, and their context.

To illustrate this point, in the case of a corporation, the natural beneficial owner would be the shareholder holding at least 50% plus one of the voting shares, which would render him or her the necessary majority to control the company. However, that is not always the case. There are a number of situations that can hinder the usual means of identifying the beneficial owner of the company. For instance, a common situation is when none of the shareholders holds the

¹²⁴ World bank, *The Puppet Masters*, 19.

¹²⁵ *Ibid.*, 33.

controlling interest. In such event, a deeper examination of the company's control mechanisms is necessary in order to determine its true beneficial owner.

There are also alternative direct control mechanisms through legal ownership. They can be manifested in a shareholders' agreement (company's shareholders agree how the company will be managed and controlled), exercise of dominant influence, or the power to appoint senior management. Other relevant predicaments may also exist, for example, whether the company has issued convertible stocks or bears any debts that are convertible to voting equity. All these circumstances, outside the traditional governance structure, can heavily affect the control of the company and, thus, need to be accounted for.

Besides these forms of direct control exercised through legal ownership, there is also the possibility of indirect control, that is, beyond formal ownership or through a chain of corporate vehicles. These other forms of control are exercised without any legal ownership or authority. The true beneficial owner might exercise its control using an intermediary. For instance, it can exercise indirect control by participating in the financing of the enterprise, or through family, historical, or close relationships.¹²⁶

Lastly, according to FATF Guide to Beneficial Ownership, control may be presumed even when there are no evidences of its exercise. Simply using, enjoying or benefiting from assets owned by legal persons can presume beneficial ownership.¹²⁷

Therefore, the identification of ultimate control cannot always be restricted to the usual legal authority paths, but it may require further examination of the legal person's context.¹²⁸

3.2.1.2 *Natural Person*

Only natural persons can be beneficial owners. This accords to the fact that natural persons always ultimately control legal persons. Conscious of this fact, FATF definition of beneficial owner clearly states that it refers to "natural person(s) who owns or controls a customer", and does not envisage legal persons as part of the definition.¹²⁹

3.2.1.3 *Beneficial Ownership vs. Legal Ownership*

¹²⁶ FATF, *Guidance*, 15.

¹²⁷ *Ibid.*, 16.

¹²⁸ *Ibid.*, 15.

¹²⁹ *Ibid.*, 8.

Evidently, the beneficial owner of an asset holds its beneficial ownership. However, that does not necessarily mean that it will also hold its legal ownership. That is because beneficial ownership and legal ownership are not synonymous. While the latter correlates to the legal title, the former is associated with control exercised over it. Certainly, in most cases, those who hold the legal title are the ones to have control and receive the benefits from it. However, there are situations whereby these two figures are found in two or more different persons.

For example, in a case in which company "A" owns shares of company "B", although company "A" would hold the legal ownership of company 'B', the same is not true regarding its beneficial ownership. As explained in the last item, only natural persons can be beneficial owners due to the ultimate control element. Therefore, in this case, the beneficial owners would be the shareholders of company "A", assuming they were natural persons.

3.2.1.4 Transactions and the "Ultimate Solicitor"

The definition of beneficial owner includes also the "natural person on whose behalf a transaction is being conducted". This inclusion seeks to encompass situations in which the beneficial owner does not control directly the persons involved in the transaction, but, nevertheless, plays a central role in it. The transaction is in this third party's interest and benefit, and, hence, this person needs to be identified. This is a fundamental element of the definition, because transactions can be deliberately construed in a fashion to avoid the identification of the beneficial owner through control chains and ownership structures, but still retain the benefit of it.¹³⁰

The World Bank/UNODC goes even further on the interpretation of this part. The World Bank/UNODC believes that this concept also encompasses the idea of an "ultimate solicitor", that is, the company's employee who, inside the corporate governance, ultimately controls the transaction. Within the anti-money laundering and corruption area, it is significantly more relevant to identify such person because the identity of major shareholders and the board of management is already public information. Furthermore, the identification of the "ultimate solicitor" is highly valuable with regard to combating corruption, money laundering, and even fraud, since the whole operation can be set to facilitate such activities.¹³¹ The idea of the "ultimate solicitor" and its importance for beneficial ownership information is also shared by

¹³⁰ *Ibid.*, p. 8-9.

¹³¹ World Bank, *The Puppet Masters*, 22.

FATF, as this body recognizes individuals within the company that can potentially exercise control through their official position.¹³²

3.2.1.5 *Legal Arrangements*

FATF definition includes as "beneficial owners" persons "who exercise ultimate effective control over a legal person or arrangement". Legal arrangements were included in the definition of beneficial ownership because their particular legal structure may conceal the identity of those who control it.

Trusts, for instance, present three main characters. The settler, who established the trust. The trustees, responsible for managing the trust. And the beneficiary, who receives the benefits of the trust. The specific features of trusts allow all of the persons involved to potentially be beneficial owners. The settler, because he or she established the trust and, thus, controlled all the aspects of it. The trustee, because he or she will be exercising control over the trust. The beneficiary, because he or she will be benefiting from it, and it can serve as a presumption of control, as explained previously. This particular legal structure of trusts results in a higher potential to disguise who is the actual controller of it. For this reason, legal arrangements, especially trusts, were included in the beneficial owner definition.

3.3 **Conclusion**

The current international legal framework extensively covers the main aspects surrounding beneficial ownership in order to prevent its concealment. This is mainly due to the FATF Recommendations, since that UNCAC's contributions to the preventative framework are unsubstantial compared to the Recommendations. The Conventions provisions are vague and qualified, rendering their obligations to State Parties non-mandatory.

By contrast, the FATF Recommendations not only envisages the obligations established by the UNCAC, but also provides for additional measures that countries must implement. The Recommendations also have an effective enforcement system in place to ensure compliance with the measures. Additionally, the Recommendations harmonized the definition of beneficial owner, a necessary measure for the international cooperation in terms of information sharing.

¹³² FATF, *Guidance*, 16: recognizes employees responsible for strategic decisions that fundamentally affect the business practices, as well as those who exercises executive control over the regular affairs of the company by its senior management position.

Yet, FATF Recommendations merits are followed by legitimacy issues. It was drafted by a few developed and developing countries. The restrict participation in the drafting of the Recommendations is not a legitimacy issue *per se*, given that countries have can freely chose to adopt them or not. However, they are also enforced into non-member countries of FATF, which raises some legitimacy issues.

4 Effectiveness of the International Preventative System

This chapter discusses the effectiveness of the current international preventative framework. It first contends that the framework has a low degree of effectiveness, based on the continuous report of international criminal investigations of cases involving beneficial ownership secrecy. It follows by investigating what are the main factors that influence states to comply with international rules and obligations. It further submits that the international preventative framework is ineffective mainly due to the lack of reciprocity of states, especially powerful ones, in implementing it. It further contends that states' interests in securing economic advantages influences them to depart from the international preventative framework.

4.1 A low Degree of Effectiveness

As discussed, international legal instruments were set in place to combat beneficial ownership secrecy. They established a preventative regulatory and supervisory framework, in which certain subjects must comply with a minimum set of rules that are enforceable in the case of non-compliance. These international legal instruments - UNCAC and the FATF Forty Recommendations - received universal endorsement by states. Yet, international criminal investigations involving the use of beneficial ownership secrecy continue to occur.

In 2011, a World Bank/UNODC study of 150 cases of major corruption reported that 128 of them involved the use of companies and the concealment of beneficial ownership to hide the proceeds of illicit activities.¹³³ Very recently, the "Paradise Papers" showed that many politicians and big companies in the world exploited the information secrecy offered by certain jurisdictions.¹³⁴ It is estimated that 8% - around US\$7 trillion of the world's personal financial wealth is located in secret offshore accounts.¹³⁵

¹³³ World Bank, *The Puppet Masters*, 33.

¹³⁴ ICIJ, *The Papana Papers*.

¹³⁵ Henry. *Offshore Revisited*, 20-23.

Additionally, complex networks of companies created to conceal the identity of beneficial owners were employed in two recent major cases of corruption, namely the FIFA bribery case,¹³⁶ and the Petrobras case, the Brazilian national oil company.¹³⁷

One may question, then, the efficiency of the international legal instruments that regulate beneficial ownership. This question demands, however, a brief overview of why states comply with international laws.

4.2 Factors that Influence states' compliance with International Law

According to the doctrine, there are six main factors affecting states' compliance with international law. Firstly, nations comply with law because of "legal belief" and 'legal habit. Simply put, states with a stronger sense of justice, and legal conscience, are more likely to obey than disobey. The same is contended for states that, by habit, are accustomed to observing international law.¹³⁸

Secondly, states comply because of consent and *pacta sunt servanda* factors. "Where a State has, in contractual forms, consented to be bound to certain rules or obligations of international law, such explicit consent requires the consenting State to honor its obligations."¹³⁹ Coupled with consent, *pacta sunt servanda* is a *jus cogens* principle and universally recognized, in which countries are obliged to comply with obligations they agreed upon.¹⁴⁰ Likewise, there are no reasons for states to disregard rules they have commonly agreed.

Thirdly, it is a necessity of international relations. States interact with each other, and such interaction must be regulated in order for states to behave in an orderly and peaceful manner. International law fulfills such functions. If states were to disregard it, the international relations between them would be impaired.¹⁴¹ Hence, compliance with international law is a matter of necessity of international relations.

Fourthly, states observe international law because of reciprocity. Mutual beneficial and reciprocal advantages must be ensured for all states in agreed obligations. As Shen comments,

¹³⁶ United States Department of Justice, *US vs. Webb et. al.* (2016), para. 82.

¹³⁷ Maira Martini and Maggie Murphy, "Just of the Show? Reviewing G20 Promises on beneficial ownership", *Transparency International* (2015), 31.

¹³⁸ Jianming Shen, "The Basis of International Law: Why Nations Observe", *Penn State International Law Review* 17(2) (1999) 340-341.

¹³⁹ *Ibid.*, 341.

¹⁴⁰ *Ibid.*, 340-341.

¹⁴¹ *Ibid.*, 342.

"if in the relations among States only one or the few States are subject to a rule of conduct while another or some others are not, such rule has no practical significance".¹⁴²

Fifthly, countries' interests are also an important factor for legal compliance. States agreed upon certain common rules because they also reflect common interests. Therefore, by complying with an agreed obligation, countries are, in fact, pursuing their interests. However, there is also the case of conflict between an established rule, and a state's national interest. In this scenario, states balance the gains and losses of compliance with the rule departing from it according with their interests.¹⁴³ Yet, states generally observe international laws because "states, by complying with international law, gains much more than they lose, and compliance is much more advantageous than disadvantageous to the State".¹⁴⁴

Sixthly, states comply with international law because their reputation would be affected by non-compliance.¹⁴⁵ They take into consideration that their disregard for international law will have a negative impact on public opinion, that is, how the media will portray their breaches, and which will be the comments of the majority of nations.¹⁴⁶ Additionally, states' credibility might suffer as a result of non-compliance. If a state is considered to be a "frequent violator of international law", it will damage its interests.¹⁴⁷

Lastly, states comply because breaching such binding obligations entails reprisals and sanctions.¹⁴⁸ The fear of reprisals and sanctions is a powerful constraint against countries the wish to disregard international law.

4.3 The Non-Compliance to the Preventative System: Economic Advantages and Lack of Reciprocity

Applying these compliance factors to the international legal framework of beneficial ownership secrecy; reciprocity, interest, reputation, and fear of reprisals and sanctions factors deserve special consideration. However, the main factors that influences states to depart from the preventative framework are states interests and reciprocity. As explained previously, issues resulting from beneficial ownership secrecy are derived from the misuse of certain corporate structures for criminal activities. It is a transnational problem because jurisdictions

¹⁴² *Ibid.*, 345.

¹⁴³ *Ibid.*, 346.

¹⁴⁴ *Ibid.*, 347.

¹⁴⁵ *Ibid.*, 348.

¹⁴⁶ *Ibid.*

¹⁴⁷ *Ibid.*, 349.

¹⁴⁸ *Ibid.*

with weaker regulatory regimes allow the concealment of beneficial owner's identity , and these corporate vehicles then have access to the international financial system. Hence, states have a strong interest in establishing an international regulatory regime in which beneficial ownership information is collected by and accessible to the competent authorities. By doing so, countries will prevent criminals from misusing corporate vehicles, and the crimes deriving from this misuse.

Nonetheless, the international regulatory regime relies heavily in the reciprocity of states on its implementation. As the US Treasury Secretary Larry Summers stated in 2000: "As interdependence increases, each country is as vulnerable to financial crime as the weakest link in the chain".¹⁴⁹ The problem with beneficial ownership secrecy is that it is very profitable business. As showed above, offshore accounts represent around US\$ 7 trillion. Most of this value, of course, is not related to criminal activities, but to the so called "tax planning" of multi-national companies and persons. Yet, because certain "offshore jurisdictions" provide information secrecy, the offshore business can be exploited for criminal activities. Countries are aware of the offshore business value, and the revenue it can generate for them. Accordingly, they may be persuaded to depart from the international rules on beneficial ownership secrecy, especially when the other jurisdictions do not allow such "offshore services". Reciprocity, hence, is a fundamental factor for regulating the problem, and countries "opportunism" is its main vulnerability.

Thus, nations must balance their interest in generating wealth by allowing information security with their responsibilities pursuant to international law. Disregarding international rules inherently entail reputational costs - as states may be labelled "tax havens". Additionally, they face severe sanctions, such as "black listing" and financial transactions restrictions, imposed by FATF.

Notwithstanding, in some instances this balance shifts more to the "opportunism" side. In the common imagination, as well as in the literature, "tax havens" are "small countries, commonly below one million in population, and are generally more affluent than other countries".¹⁵⁰ This concept holds some truth, since that most tax havens are indeed small countries.¹⁵¹ However, it does not correspond with the entire reality. Major OECD states, like the United States and Great Britain, are also considered tax havens.

¹⁴⁹ U.S. Department of the Treasury, *Cancun*.

¹⁵⁰ Dhammika Dharmapala, James R. Hines Jr., "Which Countries Become Tax Havens?," *National Bureau of Economic Research*, Working Paper 120802 (Cambridge, 2006), 1.

¹⁵¹ *Ibid.*, 7.

In 2018, the NGO Tax Justice Network produced the "Financial Secrecy Index", which ranks jurisdictions according to their secrecy and scale of their offshore financial activities. Interestingly, the United States ranked second place, just behind Switzerland.¹⁵² According to the NGO's report, the United States increased its market share in offshore financial services by 14% between 2015 and 2018.¹⁵³ The report contends that:

The U.S. provides a wide array of secrecy and tax-free facilities for non-residents, both at a Federal level and at the level of individual states. Many of the main Federal-level facilities were originally crafted with official tolerance or approval, in some cases to help with the U.S. balance of payments difficulties during the Vietnam War; however some facilities such as tolerance by states like Delaware or Nevada of highly secretive anonymous shell companies are more the fruit of a race to the bottom between individual states on standards of disclosure and transparency.¹⁵⁴

There are further evidences corroborating the claim that the United States is one of the biggest tax havens in the world. Along with the NGO Tax Justice Network's index and report, the World Bank compiled a databased of major corruption cases in the world, which concluded that the United States was the most common jurisdiction for incorporation of the shell companies involved.¹⁵⁵

It is worth noticing that the United States not only exhibits reciprocity issues in the international legal sphere, but also in its federal states system. States of the same federal system compete among themselves to attract the financial market by lowering transparency standards and taxes. This is a very startling fact, considering that the United States in a forefront in the fight against tax havens and its anonymous services. The Report further underlines such controversy between the United States' international discourse and its own actions:

While the United States has pioneered powerful ways to defend itself against foreign tax havens, it has not seriously addressed its own role in attracting illicit financial flows and supporting tax evasion. It is currently a jurisdiction of extreme concern for global transparency initiatives: instead of agreeing to join and comply with the emerging global standard of multilateral information exchange, the OECD Common Reporting Standards (CRS), it has stuck with its own FATCA model (see below), which does not appear to mesh with the CRS

¹⁵² Tax Justice Network, *Financial Secrecy Index 2018: Narrative Report on USA* (2018), retrieved from <https://www.financialsecrecyindex.com/PDF/USA.pdf>

¹⁵³ *Ibid.*

¹⁵⁴ *Ibid.*

¹⁵⁵ Quoted by J. C. Sharman, "Testing the Global Financial Transparency Regime", *International Studies Quarterly* 55 (2011), 997.

despite technical similarities. Washington's independent-minded approach risks tearing a giant hole in international efforts to crack down on tax evasion, money laundering and financial crime.¹⁵⁶

Along with the United States, the United Kingdom and its Overseas Territories are also considered major tax havens. The difference between these two countries in terms of offshore business, is that while the latter developed these systems domestically, the former has been historically focused offshore in its Overseas Territories.¹⁵⁷

The strong contrast between powerful nations' actions against tax havens and beneficial ownership secrecy, and their deliberate negligence towards the issue in their own jurisdictions might indicate the reasons behind the lack of efficiency of the established international preventative regime. The "do what I say, but not what I do" stand taken by powerful OECD nations directly confronts one of the fundamental factors of compliance of international rules, which is reciprocity. As explained above, if a rule is only observed by some states, and not others, such rule has no practical significance.

Furthermore, Sharman contends that powerful nations deliberately imposed the international rules (FATF Forty Recommendations) into others through the use of enforcement mechanisms ("black listing" and financial transactions restriction) without the intention to comply with them.

The main premise of the author is that states may agree upon a international rules, even when such rules may be disadvantageous for them.¹⁵⁸ He argues powerful nations impose standards that will disproportionately benefit them:

Powerful states may exercise "go-it-alone" power by clubbing together and establishing institutions or rules that act to remove the status quo as an option for outsiders. Under the changed circumstances, states outside the club are presented with a bad option or a worse one: the first is to join up even though this will leave them worse off and the second is to pay an even heavier penalty for remaining isolated. All relevant states thus adhere to the new rule, either because they are genuinely better off or because it is the least-bad alternative open to them.¹⁵⁹

In the case of beneficial ownership secrecy, Sharman contends that the rules established through international instruments, namely FATF Recommendations, do not put stronger states

¹⁵⁶ TJN, *Narrative Report on USA*, 1.

¹⁵⁷ *Ibid.*

¹⁵⁸ Sharman, *Testing*, 985.

¹⁵⁹ *Ibid.*, 985-986.

in a position of advantage over weaker ones. Rather, the advantage stems from the fact that stronger states lack an intention to adhere to the rules that they have created and imposed upon the weaker states.¹⁶⁰ Sharman further adds that the organizations responsible for monitoring compliance with such standards are vastly funded by powerful states, and so they do not have an incentive to denounce the misconduct of these states.¹⁶¹

In conclusion, the low effectiveness of the existing international legal instruments that regulate beneficial ownership secrecy may be attributed to the lack of reciprocity among nations. Powerful nations that significantly participated in the development of such instruments fail to comply with them. As compliance with international binding obligations is influenced by reciprocity among states, non-compliance by powerful nations may be the main factor resulting in the ineffectiveness of international beneficial ownership secrecy regulations. Some contend that the lack of reciprocity between states is deliberate. In particular powerful states may establish standards with no of intention to complying with them. Weaker nations are then required to adopt and enforce these regulations under the threats of suffering penalties and isolation.

5 Conclusion

For the effective functioning of societies, legal entities and arrangements were created in the legal domain. These so called 'corporate vehicles' were invested with legal personality and able to establish diverse relationships with other persons. Along with their autonomy and applicability, corporate vehicles can provide a relative degree of anonymity to those who control them. This fact, per se, does not constitute an issue, considering that privacy is a human right and, thus, must be respected. Yet, complete anonymity allows their potential exploitation by those with malicious intent - that want to conceal their criminal actions. To solve this problem, measures must be in place to enable the identification of beneficial owners by the competent authorities. These measures translate into a regulatory regime in which beneficial ownership information is collected and centralized, for swift access by the authorities or other relevant bodies.

Furthermore, given that the financial system is globally integrated, and corporate vehicles have easy access to it, issues arising from their anonymous exploitation - such as corruption and money-laundering - acquire a transnational nature. A weak or non-existent regulatory system in one jurisdiction that does not properly identify beneficial owners can potentially impact the others. Hence, the trans-nationality of beneficial ownership mandates a global

¹⁶⁰ *Ibid.*, 987.

¹⁶¹ *Ibid.*

approach to the associated challenges. This global response should take the form of a common regulatory framework to address possible gaps and loopholes.

International law employs a variety of different instruments which allows the international community to choose the ones most appropriate to deal with the issues at hand. More commonly, these instruments are distinguished as hard and soft law, according to different categories, such as a binary binding/non-binding, or a tridimensional (precision of rule, obligation, and delegation). Each of these categories have different features, and, thus, their adoption must take into account the applied context.

The most effective means of addressing beneficial ownership secrecy is the complementary use of hard- and soft-law instruments. Beneficial ownership issues require a common regulatory regime in which minimum mandatory obligations are implemented by states, as well the obligation for international cooperation in terms of information sharing. In this aspect, legally binding instrument are more suitable, because they will ensure stronger compliance by countries through enforcement and monitoring, as well as other non-normative factors, such as higher loss of reputation and international pressure.

Moreover, beneficial ownership issues are dynamic. Frequently, new ways of asserting control over corporate vehicles are developed, and, consequently, new ways to conceal it. In addition to that, the exploitation of beneficial ownership is more prone in certain private sectors than others. This demands a risk assessment approach by countries in order to determine which sectors require higher scrutiny of customers. Such assessments must take into account risks associated with specific regions and economies of the world. To assist countries in this complex task, technical international bodies should be enabled to participate in the policy formulation process. Therefore, soft-law instruments should be adopted on this matter, as they can be issued by non-state actors.

In the current international legal framework, the main instruments applied to beneficial ownership are the UNCAC and FATF Forty Recommendations. The UNCAC is a binding instrument, however, its drafting renders many of its provisions non-mandatory. Conversely, the FATF Recommendations is non-binding instrument, but its provisions are granted binding effect by the imposition of membership requirements and sanctions. The result is an comprehensive international framework that regulates beneficial ownership secrecy, but faces some legitimacy issues.

Despite the existence of this international legal framework, international criminal investigations involving the use of beneficial ownership do not seem to decline. Hence, the effectiveness of such legal framework is questioned. Evidences suggests that large economies,

such as the United States and the United Kingdom, which intensely participated in the elaboration and enforcement of the international regulation, have themselves not implemented them. Since reciprocity is a fundamental component of states' compliance with international rules and obligations, the lack of implementation of this framework by the powerful nations has affected its effectiveness. Some even contend that the powerful nations created such standards with no intention to comply with them, as part of a strategy to secure unfair advantages in the offshore business market.

Almost a century ago, the Secretary of Treasury of President Roosevelt expressed concerns about beneficial ownership secrecy in foreign countries. Much has been developed in terms of international law, and yet it seems that beneficial ownership secrecy will continue to be a problem for a long time. The main reason, it seems, is that the offshore business market with its low tax and information secrecy yields an enticingly large sum of money. States are very tempted to become 'tax havens' to secure such value, and many succumb to it. States' economic interests often override the international rules and obligations that they themselves agreed upon, and even imposed - and continue to impose - into others.

To avoid the passing of another century with the same concerns, solutions must be developed. Perhaps the answer for the current ineffectiveness of the international preventative is the creation of a global register of beneficial ownership information. However, it is beyond the scope of this thesis the research of solutions for the preventative system's non-compliance and ineffectiveness. Further research is warrant for the development of this solution – and possibly others – to combat the global and serious problem of beneficial ownership secrecy.

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