

Compare the Beneficial Ownership Identification System from the Perspective of Anti-Money Laundering Between China and the UK

Mingyang Chen *

School of Law, Newcastle University, Newcastle Upon Tyne, United Kingdom

* Corresponding Author Email: prozacmy@163.com

Abstract. This study mainly focuses on the comparative study of the identification of beneficial owner system in anti-money laundering supervision of China and the UK. China scored poorly in The Financial Action Task Force's assessment of its anti-money laundering regime, which singled out major deficiencies in the system for identifying beneficial owners. Beneficial owner is an important concept in anti-money laundering regulation. The beneficial owner is, literally, the true beneficiary behind the company's various business practices. In today's very active economic activities, money laundering has always been the focus of law enforcement. At the same time, the complexity of corporate ownership structure and the diversity of money laundering forms have brought great obstacles to the supervision of money laundering. In such an environment, the identification and supervision of the actual beneficiaries behind the company can improve the efficiency of the supervision of money laundering. The UK received a high rating in The Financial Action Task Force's assessment and is considered to have set up an advanced anti-money laundering regulatory system internationally. Therefore, this study will find suggestions and directions for China's future institutional improvement by comparing the identification systems of beneficial owners in anti-money laundering supervision between China and the UK.

Keywords: Money Laundering; Beneficial Ownership Identification; Comparative study.

1. Introduction

“Offshore companies as a form of business have received increased attention since the release of Panama and Paradise Papers.” [1] Many companies listed in the documents are shell companies with only a form of ownership. Such firms are difficult to regulate because of their complex shareholding and control structures. Criminals use such business forms to hide the flow of funds and the purpose of transactions for money laundering and terrorist financing. As a result, the market's business environment and operating orders have been seriously damaged. “However, despite the complexity of offshore operations, there is always a natural person behind the company to control the actual asset activity and profit from it.”[2] Given this phenomenon, anti-money laundering organisations proposed to limit and supervise money laundering by identifying the actual beneficiaries behind the company.

This study will compare the legal systems of identifying beneficial ownership between the UK and China from the anti-money laundering perspective. The legislative provisions of the two countries on this system will be compared respectively. By analysing the different systems and evaluating the systems' effectiveness to find the appropriate direction and suggestions for the Chinese future beneficial ownership identification system.

2. Reason for Comparing Beneficial Ownership Identifications Between China and UK

The Financial Action Task Force is an intergovernmental organisation to combat money laundering and terrorist financing. (The following will be referred to as FATF.)

[A]rticles 24 and 25 of "FATF 40 recommendations for beneficial ownership regulation" clearly distinguish between basic ownership of legal persons and beneficial ownership. Members need to

ensure that anti-money laundering authorities and relevant agencies obtain timely and accurate information on beneficial owners and actual controllers of legal persons. [3]

Member states have widely accepted this proposal, and the identification of beneficial ownership systems has been applied in anti-money laundering supervision. The beneficial ownership system was born because the structure of business forms such as shell companies and trusts used to launder money and illegal financing was too complex. There is considerable resistance to going after these companies directly to combat money laundering. Identifying beneficial ownership systems is to bypass these complex business forms and directly find the beneficiaries hidden behind them.

The Chinese beneficial ownership system in anti-money laundering was set up late. Because of the deficiencies in legislation and implementation, China's beneficial ownership identification system has attracted much criticism. From a realistic perspective, money laundering cases have occurred frequently in recent years. "In 2021, the People's Bank of China and its branches issued 450 anti-money laundering fines and 308 orders were punished for failing to fulfil beneficial ownership identification." [4]

In contrast, "the UK achieved a high assessment result on the FATF assessment of the beneficial ownership regime." [5] At the same time, as a country dominated by the case law system, the UK has set up many statutory provisions in anti-money laundering law, similar to the Chinese judicial model. Therefore, this study chooses China and the UK as the object of comparison, aiming to find suggestions for improving the system for China from the relevant regulations of the UK.

3. Introduction to the Chinese System

The beneficial ownership system in China started late. In 2007, China's anti-money laundering department pointed out in a document:

[T]he natural persons who control the client and the actual beneficiaries of the transaction are mainly targeted the clients who do not actively disclose that they engage in transaction activities as agents, but people other than the principal may still control the transaction of the agent or enjoy the ultimate benefits of the transaction. [6]

This description reflects "actual control" and "ultimate benefit", the two core concepts of beneficial ownership, but does not stipulate specific identification criteria. Because of this defect, the Chinese State Administration for Market Regulation issued relevant documents from in 2021 to stipulate beneficial ownership identification standards.

According to the documents:

[a]. Natural persons who directly or indirectly control more than 25% of the shares of the company or partnership may be identified as beneficial owners.

b. Natural persons who fail to directly or indirectly own more than 25% of the shares of the company or enterprise, but can individually or jointly exercise actual control over the company or enterprise, will also be identified as beneficial owners.

c. If the above three circumstances do not exist, the person in charge of the daily operation and management of the company or enterprise shall be identified as the beneficial owner, such as the company's legal representative. [7]

It can be seen that the standard adopts the layer-by-layer identification method to determine the beneficial ownership of the company by the natural person who owns the ultimate controlling shares. When it is difficult to identify equity control, it is determined by identifying the actual control right. Finally, identify the senior management of the firm when neither of the first two approaches can be carried out. However, the above provisions only stay in the normative documents, and their legal level is low. In 2021, China stipulated beneficial ownership in the legal aspect of anti-money laundering. According to the statutory:

[T]he terms beneficial ownership, as mentioned in this Law, refers to a natural person who ultimately owns or controls a company, enterprise or other market subject or enjoys the ultimate benefits of the market subject. [8]

Among them, keywords such as "ultimate ownership", "actual control", "ultimate benefit" and "natural person" are highly consistent with the judgment criteria in the normative documents. This description is consistent with FATF's definition of identifying beneficial ownership.

3.1. Evaluation of The Chinese Regulations

In contrast to the capitalist powers such as the UK, China is still in a period of rapid economic expansion. China does not strictly regulate companies' business practices to stimulate the economy. This situation somewhat promotes liquidity but also leads to huge hidden dangers. In the Mutual Evaluation Report on China's Anti-Money Laundering and Anti-Terrorist Financing issued by FATF, it is believed that China has four deficiencies:

- [a]. the basic information of the legal person is not accurate enough;
 - b. the money laundering risks of different types of legal persons are not assessed in detail;
 - c. the effectiveness of the working mechanism to obtain information about beneficial owners is not high;
 - d. the information transparency of trusts needs to be improved, and supervision loopholes exist.
- [9]

In response to the above criticism, some scholars believe that the main reason for these defects is the existence of loopholes at the legislative level. Some scholars argue that:

[C]hina's legal provisions on beneficial ownership need to be completed more. The identification and supervision of beneficial ownership are scattered in different laws and regulations, making it difficult to form a regulatory system." [10]

The reason for this situation is that China started late in identifying beneficial ownership. Many relevant laws and regulations are reflected through the normative documents scattered and issued by financial regulators, and there are significant deficiencies at the legislative level. Many countries in the world have amended laws or made regulations at the legislative level to meet the recommendations of FTAf on regulating beneficial ownership. Scattered regulatory documents are difficult to form a unified regulatory system, and the difficulty of judicial practice will increase accordingly. The second point that has drawn widespread criticism is that Chinese law does not stipulate beneficial ownership information of companies or enterprises.

[R]egulators obtain beneficial ownership information from companies and businesses through due diligence. Due to the lack of relevant regulations, some companies and enterprises do not pay attention to or cooperate with it. As a result, the quality of collected information is not high, which leads to obstacles to beneficial supervision. [11]

According to the law, since 2014, enterprises only need to publicise the names of shareholders or investors but may not publicise the investment information. As a result, many companies conceal specific capital contribution information, making it more difficult for regulators to penetrate the shareholding and control structure to obtain beneficial ownership information.

Moreover, it is more difficult for regulators to obtain information on companies with complex shareholding compositions. In addition, inaccurate information is also one of the important problems. Current Chinese law does not require corporate legal persons to promptly report beneficial owner information changes to regulatory authorities. Only in company law and securities law is there a requirement to update the information of legal persons. This also dramatically hinders the regulatory authorities from collecting beneficial ownership information.

4. Introduction to the UK system

The UK has clarified the judgment criteria of "People with Significant Control" (it will be referred as PSC) and relevant provisions in the Company Law. These criteria are the basis for identifying beneficial ownership in the UK. According to the law, the company's significant controller must meet any of the five criteria. The five criteria are:

- [a]. Directly or indirectly holding more than 25% of the company's shares;

- b. directly or indirectly holding more than 25% of the voting rights of the Company;
- c. Have the power, directly or indirectly, to appoint or remove a majority of the seats of the Board of Directors;
- d. Have the right to have significant influence or control over the implementation or actual control of the company;
- c. For other types of enterprises that do not have the status of legal persons, such as trusts or partnerships that meet any of the preceding conditions, persons who have the right or exercise significant influence or control in the trust or partnership. [12]

The terms "significant influence" and "actual control" in Articles 4 and 5 are relatively subjective. For these two factors, the UK issued legal guidance to give judgment criteria:

- [a]. to change the nature of the Company's operations;
- b. to change the Company's business plan;
- c. appointment and removal of the chief executive officer;
- d. making additional loan requests from lending institutions;
- e. revising or establishing bonus, profit and incentive plans for directors or employees;
- f. granting option awards or establishing incentive methods according to stock options. Natural persons other than the board of directors will also be considered to meet the criteria if their opinions can affect the board of directors' decisions or if their opinions are always supported by a majority of votes in voting. [13]

In addition to clear identification standards, the UK has also promulgated many regulations to ensure the accuracy and transparency of information. According to the regulations, "all companies or enterprises should update PSC information within 14 or 28 days, from the previous requirement of updating information once a year." [14] Under this requirement, the PSC information of enterprises should be updated promptly. Even if the changed information cannot be obtained in time, the enterprise shall record when and how the changed information can be obtained. At the same time, the regulations require that:

[C]ompanies or enterprises should register the changed information in the company's register within 14 days of the change of PSC information and to report the changed information to the central registration system within a second 14 days. [15]

In order to cooperate with the legislative provisions, the UK establishes a combination mechanism to obtain information fully. The UK's mechanism for acquiring beneficial owner information consists of a register for the company, a central registration system at the "companies house", and customer due diligence measures by obligators. These three mechanisms work together to guarantee the efficiency of collecting beneficial owner information.

In addition, the business form of money laundering is very complex. In response to this phenomenon, the UK has made more provisions for beneficial owner regulation in different business forms. According to the law,

[A]ll companies cannot issue bearer shares. For existing bearer shares, the company must change them to registered shares within nine months. Otherwise, the court will terminate the validity of the bearer shares that still exist after nine months. [16]

4.1. Evaluation of The UK Systems

"The UK's work identifying and supervising beneficial ownership was highly recognised in the fourth round of the FATF assessment. FATF believes it is a global leader in transparent beneficial ownership information." [17] First, the UK passed legislation to close regulatory loopholes. Regarding the definition of beneficial owner in the FATF, the definition of "PSC" is clearly defined in the Company Law and precise requirements are given for the identification criteria. In addition, the UK has also issued regulations to more carefully interpret the more subjective core elements of the identification criteria, such as "actual control" and "significant influence".

Second, in practice, the accuracy and transparency of information are the focus of identifying beneficial ownership. The UK has established an organisational mechanism through legislation to

ensure the accuracy and transparency of relevant information. In the legislation, enterprises are required to update beneficial owner information promptly, and legal provisions are made on the content of registered information. Given the complexity of money laundering, the UK has also made targeted provisions for different business forms through legislation.

This article argues that the efficiency of determining beneficial ownership identification comprises the following factors. The first is the completeness of the legislative level. The attitude of the UK to check and fill the gaps in legislation not only stipulates the objective criteria but also interprets the subjective factors in detail. Combining the two aspects makes the criteria for identifying beneficial ownership completely. The second is the accuracy and timeliness of information. In this regard, the UK regulates information registration and updates through legal provisions and establishing a combination mechanism. This practice guarantees the accuracy and timeliness of beneficial ownership information in the UK and facilitates regulation. The third point is the plurality of legal provisions. Because of the complexity of money laundering, UK law has set up special provisions for beneficial owners in different business forms. This practice demonstrates the inclusiveness and diversity in identifying beneficial ownership in the UK.

“The UK has long been a relatively flexible and low-cost place to set up corporations and welcomed overseas investment. It has prompted some authors to declare London the capital of money laundering.” [18] However, even in such an environment, the UK's beneficial ownership system is still highly recognised by the FTAF. This article believes that the above three factors lead to such benign consequences.

5. The future improvement advice of the Chinese system

By contrasting the institutional differences between China and the UK, this article argues that the first thing China needs to improve is to refine the identification criteria at the legislative level. The administrative measures issued by the financial regulatory authorities set out the criteria for identifying beneficial ownership. However, the legal level of the document is not enough, resulting in low effectiveness. Although China has stipulated beneficial ownership in the anti-money laundering Law, there is no specific identification standard. This article proposes to refer to the UK legislative provisions identifying beneficial ownership. The identification criteria should be clearly defined in the law, and a combination of subjective and objective factors should be adopted. For identifying beneficiaries, "significant influence", "actual control", and "actual profit" are the three most central factors. The first two can be easily judged by identifying equity and voting rights. Therefore, it can be identified by setting specific equity and voting rights thresholds. However, the third factor is more subjective. If there is no specific interpretation, it allows criminals to take advantage of the loophole. This study argues that the efficiency of identifying beneficial ownership in China can be improved by supplementing legal provisions to interpret this element and combining it with existing legislative provisions.

The second point is to improve the efficiency of collecting beneficial ownership information. As mentioned above, China has many defects in collecting beneficial ownership information. First, the UK legislated the concept of PSC, collected specialised information, and established a combination mechanism to improve the information collection channels. However, China lacks legal provisions to regulate the specialised sectors of beneficial ownership. The existing law only provides for the updating of corporate information. This creates a significant impediment to identifying beneficial ownership. The collection of information is the focus of identifying beneficial ownership. Because if the information collected is inaccurate or lagging, the subsequent identification work is equivalent to wasted effort. China has relaxed corporate registration requirements to stimulate the economy and encourage the creation of more companies. In response to this phenomenon, this study supposes that China can follow the practice of the UK legislation stipulating PSC, stipulating a specific section of beneficial ownership information in the legislation, and simultaneously stipulating enterprises' legal obligation to update beneficial ownership information. Increase the approach to collecting

information when there are adequate legal guarantees. One can refer to the combination mechanism established in the UK to collect information with multiple channels. To establish an integrated information system so all regulatory authorities can share beneficial ownership information to improve information transparency. The above measures can improve the accuracy and transparency of the beneficial ownership information collected by China.

6. Conclusion

This article compares the system of identifying beneficial ownership from the perspective of anti-money laundering between the UK and China. In the FTAF's mutual evaluation of the two countries, China's evaluation result is not ideal, while the UK's performance is excellent. Therefore, this article holds the attitude that China should learn from the advanced experience of the UK. Through comparison, China needs more precise provisions on the criteria for identifying beneficial ownership at the legislative level. The second is in terms of collecting information about the beneficial owner. In China, the information collected is not accurate enough because the legislation fails to stipulate the special beneficial ownership section. This study suggests that China should strengthen the obligation of companies to submit and update the information of beneficial owners through legislation and increase the information collection channels to improve the efficiency of information collection.

References

- [1] Radon. J and Achuthan. M, "Beneficial ownership disclosure: the cure for the Panama papers ills." (2017) 70 *Journal of International Affairs* 85,108
- [2] Riccardi. M and Savona.EU, "The identification of beneficial owners in the fight against money laundering." (2013) < <http://www.transcrime.it/wp-content/uploads/2013/11/BOWNET3.pdf> > accessed 10 May 2023
- [3] Recommendation 24 and Recommendation 25, FATF 40 Recommendations <<https://www.cfatf-gafic.org/documents/fatf-40r> > accessed 11 May 2023
- [4] 'China Anti-Money Laundering Report' (The People's Bank of China released the 2021 China Anti-Money Laundering Report, 30 January 2023) <<https://www.hffunds.cn/contents/2023/3/30-396f41917e7e468d9ec8b368619dc43f.html> > accessed 12 May 2023
- [5] 'Anti-Money Laundering and Counter-Terrorist Financing Measures United Kingdom Mutual Evaluation Report', < <https://www.fatf-gafi.org/content/fatf-gafi/en/publications/Mutualevaluations/Fur-united-kingdom-2022.html> > accessed 13 May 2023
- [6] Rufe Su, "International comparison of anti-money laundering beneficial owner rules" (2018) 2 *Beijing Finance Review* 118,123
- [7] 'Interim Measures for the Administration of Information on Beneficial Owners of Market Entities (Draft for Public Comment)' <https://www.samr.gov.cn/hd/zjdc/202112/t20211227_338449.html > accessed 12 May 2023
- [8] People's Republic of China Anti-Money Laundering Law (revised draft for public comment), Article 61
- [9] 'Anti-Money Laundering and Counter-Terrorist Financing Measures People's Republic of China Mutual Evaluation Report' (China's progress in strengthening measures to tackle money laundering and terrorist financing, April 2019) <<https://www.fatf-gafi.org/content/fatf-gafi/en/publications/Mutualevaluations/Fur-china-2022.html> > accessed 12 May 2023
- [10] Shu Zhao and Gang Song, "The UK's Regulatory Experience in Beneficial Ownership and Its Inspiration to China" 2018 (9) *The Chinese Banker* 113,115
- [11] Zhang. J, "Difficulties and suggestions in identifying beneficial owners from the perspective of anti-money laundering supervision (in Chinese)" 2023 (2) *China Banking* 47,49
- [12] Companies Act 2006, Schedule 1 A

- [13] 'Statutory Guidance on The Meaning of "Significant Influence or Control" over Companies in The Context of The Register of People with Significant Control ' (Company statutory guidance for the PSC register - GOV.UK, June 2017) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/675104/psc-statutory-guidance-companies.pdf > accessed 12 May 2023
- [14] The Information about People with Significant Control (Amendment) Regulations 2017, S 8
- [15] The Information about People with Significant Control (Amendment) Regulations 2017, S 8
- [16] Small Business, Enterprise and Employment Act 2015, Schedule 4
- [17] The United Kingdom's measures to combat money laundering and terrorist financing < <https://www.fatf-gafi.org/en/publications/Mutualevaluations/Mer-united-kingdom-2018.html> > accessed 12 May 2023
- [18] Hampton. M. P, "The Offshore Interface. Tax Havens in the Global Economy." (1998) 22 Capital & Class 135,137