

Beneficial Owner Identification and Verification Guideline for Reporting Entities

I. Introduction

a. Foreword

- 1.1. Legal entity (LE) is established for business, commercial and other purposes in the form of company, fund, partnership, trust, etc. These forms and types of LEs are essential to today's globalized economic and social environment. On the other hand, they can also be used for money laundering, corruption, tax evasion, terrorist financing, and other illegal activities because the complex and diverse nature of LEs create favorable conditions for hiding the income source, beneficial owner, and illegal activities before integrating the illegal income into the financial system.

Therefore, it is necessary to establish a system of disclosing the LE's information about legal owner, beneficial owner (BO), income source, and activities and providing this information to competent authorities. There are obstacles in disclosing the LE's information about BO. In particular, it is difficult to identify the BO when it comes to LE that conduct transnational activities.

Therefore, Recommendations 24 and 25 of the Financial Action Task Force on Money Laundering (FATF) focus on the LE's transparency and measures related to BO. Mongolia has taken steps to implement these recommendations and improve the legal environment. For example, it legislated amendments to the Law on Combating Money Laundering and Terrorism Financing (AML/CFT Law) and the Law on State Registration of the LE.

- 1.2. This Guideline is established to support the implementation of measures provided in AML/CFT Law such as identifying the BO indicated in Article 41, customer due diligence (CDD) indicated in Chapter 5, and supervising and determining the LE specified in Section 5.14.1.

b. Foreign and domestic regulations related to BO and transparency

- 1.3. AML/CFT Law:

Section 3.1.6 of the AML/CFT Law provides legal definitions of the BO; Article 41 of the AML/CFT Law provides the sequence of actions to be taken to identify the BO, and Chapter 5 of the AML/CFT Law provides the guidelines for obtaining LE's information necessary for CDD and other measures.

- 1.4. The Preventive Measure Regulation (PMR) set out in Article 5.14 of the AML/CFT Law regulates the measures related to LE. Chapter 4 of the AML/CFT Law contains the PMR.
- 1.5. Recommendations 10, 12, 24, and 25 and the Interpretative comments of the FATF define the international standard related to this subject matter.
- 1.6. FATF issued a handbook on "Transparency and Beneficial Owner" in October 2014 to foster understanding and improve coordination of the recommendations.

II. General provision

a. Who is a BO?

- 2.1. Section 3.1.6 of the AML/CFT Law defines BO as follows:
 - if a customer is legal entity, then a person who has a significant or controlling interest solely or jointly with others or holds a management function of the legal entity or represented by other persons or ultimately owns the legal entity earning benefit and profit by exercising control of the legal entity and its arrangement;
 - if a customer is an individual, then a person who controls customers' action and activity or represented by this person who is benefiting from it;
 - As for a legal arrangement, a person who earns benefit or profit by exercising controlling interest over the legal arrangement.

FATF Recommendation defines BO 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.
- 2.2. Reporting entities (RE) are responsible for identifying the BO and taking the necessary measures. BO is only an individual, not a company or any organization. However, the customer may be connected to several BOs. Therefore, RE is responsible for identifying, determining, and verifying the customer's BO with the documents specified in the law.

If a customer is and individual and is representing an individual, then the RE must disclose and verify the information related to the individual and BO.

b. Why it is important to identify BO?

- 2.3. The offender uses a variety of tools, techniques and mechanisms to conceal the hidden assets. The offender launders illegal money and income by creating this scheme, disguising the LE in their ownership as lawful, and entering the financial system. Studies by international organizations such as the FATF, World Bank, and United Nations Office of Drug and Crime found that the LEs are still used for illegal activities such as ML/TF. In general, the failure to collect correct information about the LE's BO creates the basis for illegal activities such as ML/TF. These include:
- Information about the alleged or suspected criminal;
 - The real purpose of the asset or property held by the LE;
 - The use of property, or origin of the property related to the LE.

In other words, the ultimate owner of the RE's customer could be a criminal and may wish to use the RE to conduct illegal activities such as ML/TF. It creates a major risk to the current globalized banking and financial system. Therefore, RE is required to conduct CDD and take appropriate actions. Thus, RE will prevent the illegal money and resources from entering the banking and financial system and will be free from ML/TF activities and other crimes.

c. How does the information related to BO is concealed?

- 2.4. There are many ways to conceal the information related to BO. The FATF's "Transparency and Beneficial ownership" handbook cites the following ways:
- Shell companies (which can be established with various forms of ownership structure), especially in cases where there is foreign ownership which is spread across jurisdictions;
 - complex ownership and control structures involving many layers of shares registered in the name of other legal persons;
 - bearer shares and bearer share warrants;
 - unrestricted use of legal persons as directors;
 - formal nominee shareholders and directors where the identity of the nominator is undisclosed;
 - informal nominee shareholders and directors, such as close associates and family, and trusts and other legal arrangements which enable a separation of legal ownership and beneficial ownership of assets;
 - use of intermediaries in forming legal persons, including professional.
- 2.5. Using these methods, criminals commit ML/TF offenses. Most offenders often create, rule, lead, supervise, influence financial operations, organize activities from other countries and conceal their offenses, themselves, and organized crime groups. This creates very difficult situations for law enforcement agencies (LEA).

III. The types and forms of the LE, legal contract's forming in Mongolia

- 3.1. Types and forms of foreign and domestic LEs:
- Companies: Limited liability (limited by shares or guarantees); Fully accountable, Limited Liability with Foreign Investment, Open Society Company, Closed Stock Company and Offshore Area;
 - Association;
 - Cooperatives and associations;
 - Foundation;
 - Partnership;
 - Non-governmental organizations;
 - Legal agreements: Discretionary trusts; Express trusts.
- 3.2. The RE should understand and control the risks associated with LE that could be not listed above, regulated by Mongolian laws, unclear to the RE or in domestic and foreign new forms of LE.
- 3.3. The RE should take measures to understand its customers before entering into any business relationship that is not listed above, and take all possible measures to identify the BO and, if necessary, to discontinue the relationship.

IV. Identifying the BO

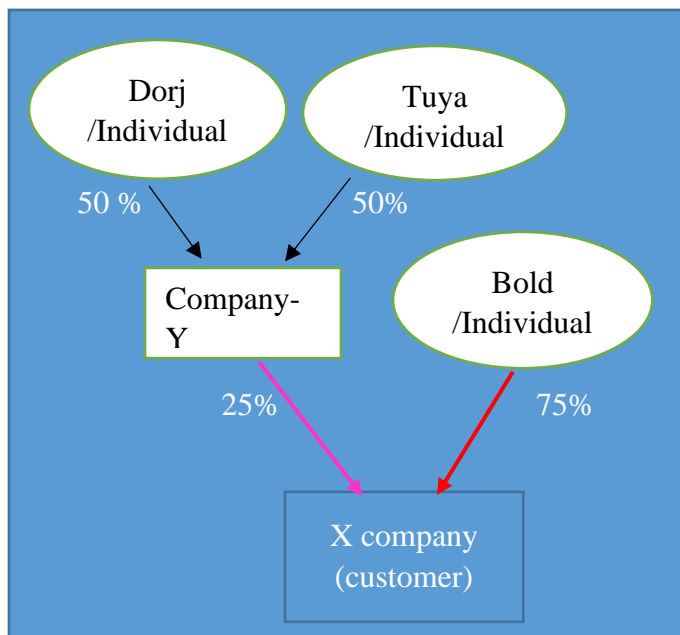
- 4.1. Each time you apply the test of beneficial ownership to a customer you must apply three elements. These elements are:
- Individuals holding a certain percentage of the LE (For Mongolia, the prescribed threshold should be interpreted to shareholder who owns more than 1/3 of the share)
 - who has effective control of the customer;
 - the persons on whose behalf a transaction is conducted.

A beneficial owner is an individual who satisfies any one element, or any combination of the three elements.

- 4.2. Determining the BO is not limited to these three factors and it is not enough to determine the BO with a single element. The process of determining the BO can be terminated only if the RE considers that it is possible to manage the risks posed by the provided client's information.

- 4.3. The BO can be identified through the percentage of shares they hold at LE and by the controlling interest they hold at the LE. However, in some cases this criteria may not be possible for identifying the BO. For example, the Mongolian law states that 33% is the threshold but in some cases it is possible that the individual who holds less than 33% is the BO.
- 4.4. There may be individuals who have effective control over the customer, but are not a shareholder. In this case, that individual is the BO.
- a. *How to identify the BO?*
- i. Ownership - Individuals who own a certain percentage of the LE and benefit from the ultimate benefit and profit (for Mongolia, it is the controlling shareholder).
- 4.5. You will need to understand the ownership structure of your customer. If the ownership structure breaks down and creates a chain, the RE must continue to determine the BP until the ultimate beneficiary is identified.

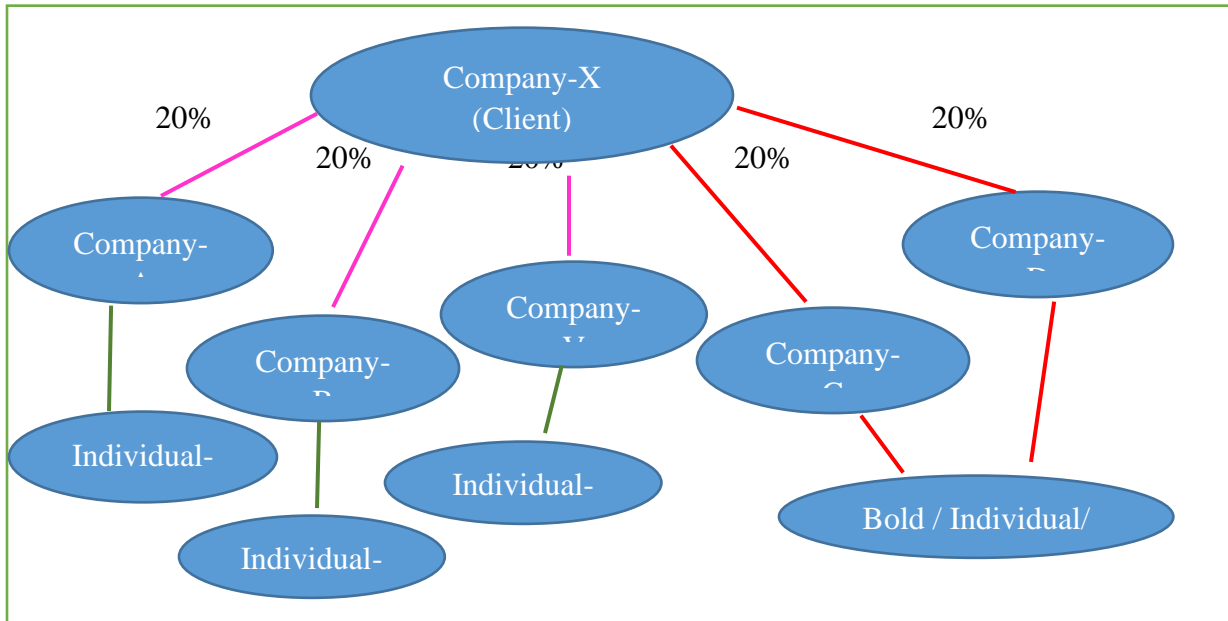
Diagram 1: Structure of ownership



X Company is directly owned by an individual, Bold who owns 75% and Y Company which owns 25% and is owned equally by two individuals – Dorj and Tuya. Establish that this ownership structure is correct. You identify and verify the identity of the individuals who own more than 25% of X Company. In this case, only Bold owns more than 25% of the customer.

(the red line- majority shareholder, the pink line- minority shareholder)

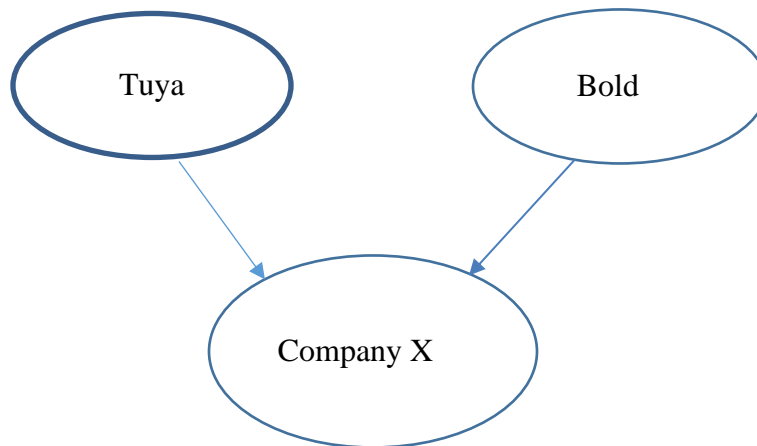
Diagram 2: Complex structure of ownership



- 4.6. If there no majority owner (all of them are minority owner), an individual who has responsibility for managing is confirmed and his or her information will be registered. the individual – who manages legal entities activity or is represented yourself by someone.
- 4.7. If necessary, consider individual who manage legal entities activity as beneficial owner. For instance, the individual who responsible for decision of client managing is consider as beneficial owner. Note that the individual is not representative person.
- 4.8. In this case, to obtain information about client managing and corporate governance. Therefore, it is able to know that who is the individual person. If there is no the individual who manage, following requirements may be considered. These include:
- or individuals with the ability to appoint and dismiss senior management of client (board, board so on);
 - or Individuals with a voting rights in the decision-making process of the client (a voting right - more than 33% of shares);
 - or senior management (executive director, president so on);
 - or a trustee authorized to manage the client's activities.

All these examples may apply to decide who has effective control rights and understanding the management and governance structure of the customer will assist to establish those persons with effective control of the customer.

Diagram 3:



Ms. Tuya holds all the voting rights for company X and Mrs. Bold has responsibility for all managerial decisions at X company. In this instance the both individuals meet the beneficial ownership definition because they both have effective control.

Acting on behalf of a customer

- 4.9. The individual who come to act on behalf of the customer can be identified as a beneficial owner. There are various scenarios, many of which are complicated. In other words, there is always ongoing transaction and account opening transaction on behalf of customer. The beneficial ownership is a person on whose behalf a transaction is conducted.
- 4.10. An example is, if a reporting entity knows that someone (person A) is conducting an occasional transaction on behalf of another person (B), then person A and person B should be identified as a beneficial owner and the information related to them should be verified.

V. Define and verify the beneficial owner's information

- 5.1. The reporting entities should implement the process of controlling identity and verifying the information of any beneficial owner, customers, person who is representing the customer and acting on behalf of them in their policies and regulations. According to the FATF Recommendation No. 10 and the act 5.4 of the AML/CFT law if the customer due diligence has not been completed or the information is not sufficient then the reporting entities must not establish a business relationship or conduct an occasional transaction for the customer. Moreover, the process assessing customer risk and identifying, and verifying the beneficial ownership should set in the bank's AML/CFT policy and regulations.
- 5.2. The reporting entities are responsible for determining and verifying the identity of the customer and the client's enhanced customer due diligence process. They must ensure

- that the relevant documents, data and information related to the customer and person who representing the customer based on the reliable source.
- 5.3. The reporting entity may obtain information and declaration in accordance with a special form to identify the client's beneficial ownership. However, unless such information is verified and full customer due diligence has been completed or the customer's identity is correct, it is not possible to establish and continue a business relationship or conduct an occasional transaction for the customer.
 - 5.4. The reporting entity can verify the identification and information of the customer from their documents and other source of information related to their expected ongoing/ future levels of business. In such a case, the source of the information must meet the requirements of the reporting entity's policies, procedures and customer's risk level.
 - 5.5. Apply a risk-based approach to verifying the identity of the customer. It is inappropriate to make a transaction with large amount or risky service without knowing the customer's due diligence and beneficial ownership identification process.
 - 5.6. It is appropriate to ensure that the reporting entity obtained all necessary information related customer's beneficial ownership and identified ownership of a customer must be satisfied, regardless of the level of risk associated with that customer.

VI. What if the BO cannot be identified or verified?

a. Late verification of customer information

- 6.1. To keep business relations with the customer, the RE is allowed late verification of customer information. In case of complex ownership structure, for example, it may take a long time or may not be able to obtain the customer's BO information. In such cases, the RE needs to establish a system for evaluating and managing the risk of the client. The RE should develop policies and regulations to limit the number and amount of customer transactions, watch closely the customer's unusual transactions, and terminate business relationship if risks deemed to be high. Even though BO is not identified, it is important for RE to manage and prevent risks of the customer activities and transactions until the information is collected and verified.

a. Termination of business relationships

- 6.2. If the existing client's information has not been fully verified or the information on BO is thought to be insufficient, the RE shall restrict the customer's account and transaction activities and based on information collected shall provide services or terminate the account and its activities.

c. Reporting suspicious transaction reports (STR)

- 6.3. If the KYC procedures fail due to client's refusal to provide the required information, the RE shall refuse to provide the service as described in Article 5.4 of the AML Law, and, if necessary, report STR to the FIU.

VII. PEP and other high-risk customers

- 7.1 Enhanced KYC procedures should be applied if the BO of the customer is a PEP or other high-risk client.
- 7.2 The RE shall take measures to avoid establishing a business relationship with those identified by the UN Security Council and the local authorities as terrorist, or those from countries under financial sanctions. As this is especially important for the reputation of banks and financial institutions, the RE should prevent such BO from becoming its customer.

VIII. Other requirements

- 8.1. The RE shall keep the information obtained for the purpose of determining the beneficial owner.
- 8.2. The RE shall take action to identify BO when entering into business relationships and update the relevant information regularly.

IX. Vigilance and responsibility

- 9.1. The competent authorities shall monitor the implementation of the RE obligations for identifying BO and take necessary measures as required by law.
- 9.2. Articles 11.29 and 5.10 the Infringement law shall be applied to RE for breaching BO identifying requirements.

Reference:

- Basel Committee on Banking Supervision, "Sound management of risks related to money laundering and financing of terrorism" Guidelines - <https://www.bis.org/bcbs/publ/d353.pdf>.
- ИБ, Register of People with Significant Control, Guidance for registered and unregistered companies, societates europeaeae, limited liability partnerships, and eligible Scottish partnerships, 2017
- COMPANY LAW OF MONGOLIA - <https://www.legalinfo.mn/law/details/310?lawid=310>
- Preventive Measures Regulation - https://www.mongolbank.mn/documents/regulation/control_check/20190121_A26.pdf
- ФАТФ (2012-2018), International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation, FATF, Paris, France, www.fatf-gafi.org/recommendations.html
- FATF, Guidance on Transparency and Beneficial Ownership, 2014
- Law on State Registration of Legal Entities - <https://www.legalinfo.mn/law/details/13591?lawid=13591>
- New Zealand, Beneficial Ownership Guidelines, 2012 – to assist reporting entities in meeting the requirement to perform CDD on the customer and beneficial owners of the customer