Association Romande des Intermédiaires Financiers

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NOTE ON INTERPRETATION

Date: 15 June 2018

Re: Identification of the contracting party and the beneficial owner

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Some differences of interpretation have appeared on the part of certain financial intermediaries over identification of the contracting parties and beneficial owners. ARIF has therefore decided to issue this note on interpretation in order to clarify the situation. It is accompanied by a diagram to which reference is made in the text.

There are two conflicting approaches:

1. One that can be described as the "legal" approach:

a. The contracting party

The contracting party is a purely juridical notion that designates each individual or corporate entity that owns the assets that are the subject of the business relationship, and to whom/which the financial intermediary is linked by a written or oral, tacit or express contractual relationship.

Such a contract may exist not only in the basic relationship but also when each of the legal acts that accompany the transfer of assets from one person to another is performed. This is because there is no transfer of ownership without a legitimate legal reason. Such contracts also exist between each of the actors of the structure to define their role, term of office as director, fiduciary contract, etc.

For each contract, there must be a corresponding declaration by the beneficial owner of the assets involved, sent by each contracting party who transfers, deposits, appoints or designates, to the party who receives, is appointed or designated.

b. The beneficial owner

The beneficial owner is the person, who is necessarily an individual, who has the power to make use or dispose of, for his/her own benefit or for the benefit of third parties whom he/she designates, the assets that are the subject of the contracting party's business relationship with the financial intermediary.

These two capacities (beneficial owner and contracting party) may be combined in one and the same person when the latter is an individual. These capacities can also be divided between several people, and this will always be the case when the contracting party is a corporate entity.

The same financial intermediary may have several contracting parties in respect of the same assets, and there may also be several beneficial owners of these same assets.

This will be the case particularly where complex structures are concerned, involving one or more domiciliary companies or entities.

c. Implementation

A financial intermediary which is a director of a domiciliary company may find itself bound by a fiduciary mandate contract vis-à-vis the individual who requested it to establish the domiciliary company, to execute his orders relating to the latter, and often also to hold on a securities account the instruments – share certificates and other securities – evidencing the rights of the creator of the structure to that structure.

In addition to this, there is a contract of appointment as a director or holder of general power of attorney of the domiciliary company, which is entered into by the financial intermediary with the domiciliary company itself, of which the financial intermediary handles the direct *de jure* or *de facto* management.

There will therefore be two contracting parties of the financial intermediary but only one beneficial owner, who is often also the contracting party that is the individual.

In its dealings with this contracting party, the financial intermediary will require that a form A be signed indicating that this contracting party is indeed the beneficial owner of the assets that are the subject of the business relationship. If this is not the case, the name of the third-party beneficial owner shall be indicated by the contracting party (diagram, contractual link 1).

As a director or holder of general power of attorney of the company, the financial intermediary shall declare said company as the contracting party in its dealings with third parties, for example the custodian bank, by indicating the name of the beneficial owner of the company, according to the instructions that it will have been given by the contracting party that requested it to form the company and which instructs it in a fiduciary capacity (diagram, contractual link 2).

Furthermore, the contracting party of the financial intermediary is also the contracting party of the domiciliary company formed for its account and to which the assets will be transferred.

Even if practitioners are sometimes unaware of this, the transfer of assets to the domiciliary company is in itself a separate contractual juridical act, because it may not

be carried out "without a legitimate reason". Even if it is often never expressed, this contractual relationship is generally fiduciary in nature, sometimes camouflaged in the form of a loan or a partner's contribution, all of which are acts that do indeed constitute contracts intended for the transfer of assets. Practitioners cannot be recommended strongly enough to document the legal reason for each of these transfers, by a separate contract.

Considering that the domiciliary company itself has a contractual relationship with the transferor of the assets, it would, in principle, be necessary for it to have the latter sign a form A designating the beneficial owner of the assets transferred (diagram, contractual link 3).

However, since in practice this contracting party is often the same as the contracting party of the financial intermediary, which is itself the director or holder of power of attorney of the company, it is sufficient to have the contracting party sign only one form A. This form applies both to the financial intermediary and to the domiciliary company and is sent to both, designating the beneficial owner in both cases (diagram, junction of the contractual links 1 and 3).

One can thus supplement form A containing the beneficial owner's declaration and signed by the initial client (the one for the purposes of whom the financial intermediary established the structure) with the words:

The contracting party ... declares that the beneficial owner(s) of the assets involved in its(their) relationship with the financial intermediary (name of the FI: .....), or as applicable with the company(ies) (name of the company(ies)): …… administered by the financial intermediary for the account or on the orders of the contracting party, is/are: ……..

However, this applies only if this beneficial owner is actually the same in both cases (establishment of the structure or, as applicable, transfer of assets), which is not compulsory, particularly when there are several beneficial owners of the same assets or the same structure, or when the structure is established by the financial intermediary at the request of an agent of the beneficial owner.

In the case of conventionally-established trusts, the situation breaks down into two time phases: the financial intermediary first of all enters into a contractual relationship with the settlor, its purpose being to set up the trust and possibly to put in place its infrastructure.

If the assets are given in trust to the trustee as from the time the trust is established, the trustee shall require the settlor to complete a form A before or at the same time as the trust is established, in order to determine who is the beneficial owner of these assets.

If the assets are transferred to the trust after the latter has been established, each transferor of such assets must be deemed by the trustee to be a donor. Acceptance of

the transfer *inter vivos* constitutes acceptance of a donation in trust, which is a contract. In this case, the trustee must obtain declaration A from the donor who is his contracting party (and is not always the settlor).

At the same time, once the trust is established, the trustee financial intermediary draws up a form T, which collects the relevant information on all the players in relation to whom the trustee has rights or obligations, namely the settlor, the beneficiary, any third-party protectors, etc. The same applies in the case of an unconventional trust, for example, when the trustee is appointed by a deed on account of death, or in the case of a constructive trust.

Considering that in the trust structure that has now been established, none of these people is to be deemed a contracting party by the trustee, the form T is not signed by these people but by the trustee himself.

It is this information that the trustee will forward to any potential third contracting parties with which it would contract, for example the custodian bank.

Finally, the trustee will take care to replicate the form T in the files of each of the infrastructures that it creates to hold the trust's assets.

2. The pragmatic approach

The so-called pragmatic approach developed in the early days of the MLA for reasons of simplicity or lack of understanding on the part of financial intermediaries. It involves considering as contracting partner solely the "client" in the commercial sense of the term, that is, the person who is generally in charge of actually paying for the financial intermediary's services and who has the ultimate and/or actual power to unilaterally remove the financial intermediary from office or to strip the structure of its assets.

In this pragmatic approach, abstraction is made of the structures, be they superstructures or infrastructures, as they are all deemed to be ordinary working tools with no real legal status, under the theory of transparency.

In this approach, the notion of contracting party becomes blurred with that of "client" or "business relationship".

This approach has the advantage of simplicity.

However, it has various disadvantages.

First, of not being compliant with the legal systematics.

Also of often being factually and legally wrong; the same business relationship may comprise several clients and several contracting parties, who are not necessarily the beneficial owners, or even the “clients” in the commercial sense of the term.

Then of leading to certain aberrant forms of behaviour, for example, when the financial intermediary gets the beneficial owner to sign the beneficial owner’s declaration issued by the domiciliary company as the contracting party of the financial intermediary or third parties, whereas it is the financial intermediary itself, as a director or holder of power of attorney of this company, which should sign this declaration, indicating to third parties who is the beneficial owner.

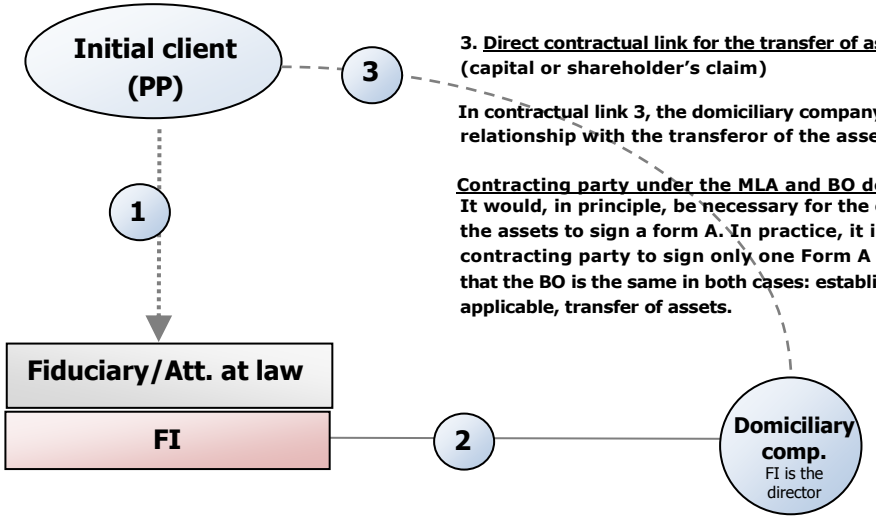
The pragmatic approach also has some perverse effects, especially with regard to trusts, since it clearly shows that the trust is only a disguised fiduciary structure, a “sham trust”.

The pragmatic approach may also pose some difficulties in the event of a change in the situation or the structure, particularly in the event of the death of the “client” or of a change of beneficiaries or a split of the beneficial owners.

This is particularly troublesome for financial intermediaries managing many business relationships over a long period of time, with a large staff liable to change over time.

For these reasons, it is necessary to standardise practice along the lines of the legal approach - even if it results in more paperwork - and to build up and supplement the AML Register accordingly.

Contracting party and BO
Case of the domiciliary company with an office as director
(held by an employee of the FI or by the FI itself as a company)



3. <u>Direct contractual link for the transfer of assets</u>
(capital or shareholder's claim)

In contractual link 3, the domiciliary company itself has a contractual relationship with the transferor of the assets.

<u>Contracting party under the MLA and BO declaration</u>:
It would, in principle, be necessary for the company to get the transferor of the assets to sign a form A. In practice, it is sufficient to get the initial contracting party to sign only one Form A (junction of 1 and 3) provided that the BO is the same in both cases: establishment of the structure or, as applicable, transfer of assets.

1. <u>Fiduciary mandate</u> given by the Initial Client to the FI for the establishment of a domiciliary company, execution of his orders relating to this company, possibly holding on deposit share certificates and other securities relating to the establishment of the domiciliary company.

<u>Contracting party under the MLA and BO declaration</u>:

In contractual link 1 (and seen from the point of view of the FI), the Initial Client (PP) becomes the contracting party (1) of the FI.

--> the FI asks him for a BO's declaration (Form. A), in which the Initial Client (PP) declares who is the BO of the assets involved in his relationship with the FI, or as applicable, with the company or companies administered by the FI for its account:
1.1 : if it is the Initial Client (PP) himself
1.2 : if it is a third party (PP)

2. <u>Office as director</u> of the domiciliary company conferred by the AGM of the domiciliary company on an individual employed by the FI or to the FI as a company.

<u>Contracting party under the MLA and BO declaration:</u>

In contractual link 2 (and seen from the FI's viewpoint), the domiciliary company becomes the contracting party (2) of the FI.

--> As director of the domiciliary company, the FI will declare the latter as the contracting party in its relations with third parties (in particular to the custodian bank or its SRO for the listing of its business relationships in the AML Register) indicating the name of the BO of the domiciliary company (1.1 or 1.2), according to the instructions provided by the Initial Client (contracting party 1) that requested it to form the company and that instructed it in a fiduciary capacity.