Open Ownership

Defining and capturing information on the beneficial ownership of investment funds

Policy Briefing

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Overview

Investment funds play an important role in financing the global economy and adding liquidity to financial markets. An investment fund generally refers to a type of collective scheme that pools together money from different investors, both individuals and institutions, to invest in different types of assets, including real or financial assets. Broadly, they are classified as retail versus private investment funds. Retail investment funds are those which are available to the general public, such as listed mutual funds. Private investment funds, also referred to as alternative investment funds, are only available to specific categories of investors who often have access to large amounts of capital.

The investment funds market is vast and growing. As of 2022, approximately USD 61 trillion worth of assets were under management of investment funds globally, an amount roughly equivalent to the combined gross domestic product of China, the European Union (EU), and the United States (US).[1] Civil society organisations have raised concerns over the lack of beneficial ownership transparency (BOT) in the investment industry as being a factor that makes investment funds attractive for potential misuse. Although the full extent to which investment funds are used for the purposes of money laundering and other financial crimes is unclear, there is a growing number of documented cases. The misuse of private investment funds, as opposed to retail funds, is of particular concern.

BOT is an area of policy reform that refers to governments putting in place requirements for corporate vehicles, such as companies, trusts, and other forms of legal entities and arrangements, to collect and disclose information about their beneficial owners in a register. Governments collate this information and make it available to a range of actors, including law enforcement, tax authorities, the private sector, as well as civil society. There are significant practical challenges to applying beneficial ownership (BO) disclosure requirements to investment funds. The high speed of trading in securities globally means that aggregate ownership of any one individual in an investment fund may change in intervals of seconds, and ownership interests are typically held through layers of intermediaries. The challenges are similar when applying BOT to publicly listed companies (PLCs), and they are addressed in a separate Open Ownership briefing.[2]

Given the size and complexity of the investment industry, BOT is only one of many policy measures that can improve its transparency and accountability. Others, such as stronger anti-money laundering (AML) requirements on both registered and unregistered investment advisors and full disclosure of interests in financial assets, are also highly significant but fall largely outside the scope of this briefing.[3] The Financial Action Task Force (FATF) has classified the securities sector as high-risk for money laundering.[4] In many jurisdictions, investment funds are subject to AML regulations, but they are often imperfectly applied.

Where BOT is being implemented, some jurisdictions have explicitly exempted some or all investment funds from disclosing beneficial ownership information (BOI) to a government register and have no minimum BO reporting requirements. Civil society groups have pointed out that there is a risk that the introduction of BO registers could lead to a shift of illicit finance from anonymous companies to the less-transparent investment industry if similar standards are not applied.[5]

Due to limited research on the BOT of investment funds, many questions remain underexplored: for instance, whether BO disclosure is an appropriate instrument to generate useful information for their oversight; and how BOT regimes can effectively include investment funds, for example, by placing specific requirements on fund managers or institutional investors to disclose certain information.

This policy briefing aims to contribute to filling this gap by analysing the existing policy and regulatory framework on the BOT of investment funds at the international level. It provides considerations to help policymakers and those implementing or supporting BOT reforms to think through various issues and approaches toward ensuring effective transparency and oversight of investment funds. It also outlines recommendations for the operationalisation of BOT measures by identifying emerging practices in legal and policy reforms.

International AML standards are a key policy driver for BOT reforms, and most documented cases of the misuse of investment funds involve money laundering and related financial crimes. AML is therefore the main focus of this briefing. However, given their involvement in such a significant share of the global economy, not knowing who ultimately owns, controls, or benefits from investment funds risks undermining a range of policy objectives that countries typically pursue through BOT.

Broadly, the research concludes that including investment funds within the scope of a jurisdiction's BOT regime can be a good approach to effectively regulating and preventing their misuse. Key considerations for implementers include:

- considering whether the existing legal definitions of the beneficial ownership of legal entities and arrangements are fit for the purpose of applying BOT to investment funds, which can be organised in a variety of legal forms and include the use of multiple layers of intermediaries;
- to adequately capture BOI on investment funds, it may be necessary to include the concept of deriving benefit from a corporate vehicle in the definition and to adjust reporting thresholds downward to capture information on all relevant parties enjoying ownership, benefit, and control;
- making all investment funds – regardless of their legal form – subject to BO disclosure requirements, unless reasonably exempt;
- when granting an exemption from the BOT regime, creating clear criteria for the basis of exemption, whilst ensuring that equally adequate, accurate, and up-to-date information on the beneficial ownership of investment funds is available in a timely manner, when required, through an alternative mechanism;
- considering the relative levels of risk of misuse among different types of investment funds, for purposes such as money laundering, in setting out disclosure requirements that are at once adequate and proportionate: namely, whether they are retail or private funds.

Introduction to investment funds

An investment fund generally refers to any type of collective scheme that pools together money from individuals, institutions (such as companies), or both to invest in different types of assets. The relevant details for investors to consider are described in one or more formal fund documents, such as a prospectus, which are typically filed with a designated authority, such as a jurisdiction's securities and exchange commission or financial services authority. The different types of investment funds, the legal forms through which they are organised, the involvement of various intermediaries, and variations in the types of assets they can hold all introduce complexities when it comes to determining the beneficial owners of investment funds.

In retail investment funds, thousands of investors may be involved via intermediaries, and they may have little or no control of the fund's activities or knowledge about the identities of other investors. The potential number of investors in a private investment fund is typically smaller than retail funds. Private investment funds tend to target high-net-worth individuals, including politically exposed persons, and fund managers may have a close relationship with their client investors.[6] A third classification is for actively managed funds that embrace a more aggressive strategy for buying and selling assets, versus passive funds that are, for example, indexed to the long-term performance of a large number of companies. Passive funds have been growing in their market share, and in some jurisdictions they hold a significant portion of ownership in publicly traded companies.[7]

Types of investment funds

There are many different classifications for investment funds. For example, some are closed-end, meaning they have a fixed number of shares or capital, whilst others are open-end, meaning they can grow into unlimited shares or capital. The number and types of investors that may be involved in a fund, which is most relevant to understanding its beneficial ownership, are generally shaped by the following classification:

a. **Retail investment funds**, which are available for any person to invest in. Many exchange-traded funds, pension funds, and mutual funds, referred to as undertakings for collective investment in transferable securities or the Undertakings for Collective Investment in Transferable Securities (UCITS) Directive in the EU, are examples of retail investment funds.

b. **Private investment funds** (or alternative investment funds), which are only available to specific categories of investors that may exist in a jurisdiction, such as advised investors, high-net-worth investors, certified or self-certified sophisticated investors, and restricted investors.[8] Hedge funds, private equity funds, venture capital funds, and family offices are examples of private investment funds. Rotating savings and credit associations are also sometimes used to pool funds for private investment, such as *Stokvels*, *Chamas*, and *Gam'eya*.[9]

Legal forms of investment funds

Whilst an investment fund may be created using different types of corporate vehicles, they are usually organised as limited partnerships, trusts, or companies. According to the Organisation for Economic Co-operation and Development (OECD), various legal forms are used for investment funds in different countries:

> In Canada and the United States, for instance, both companies and trusts are used for investment funds. In Australia, New Zealand and Japan, the trust is the predominant form [...] In many European countries, both joint ownership vehicles (such as *fonds communs de placement*) and companies (such as *sociétés d'investissement à capital variable*) are commonly used.[10]

As another example, in the United Kingdom (UK), certain limited partnerships are often used as private investment vehicles for investing in assets such as real estate. Limited partnerships are an attractive corporate form to investors due to their flexibility and the fact that limited partners are passive investors who are not involved in the partnership's routine management, thus minimising their liability. According to the British Private Equity & Venture Capital Association (BVCA), "[u]nlike in a private company (where shareholders of the same class have to be treated equally), the partners [in a limited partnership] can set the rules on matters such as how the profits are shared, how interests in the partnership are transferred and how the business is to be conducted."[11]

Types of assets held by investment funds

Investment funds allow investors to own, control, and benefit from physical (or real) assets, such as land, gold, commodities, and infrastructure projects, or financial assets, such as shares of public companies listed on a stock exchange, shares of private companies, debt issued by corporations or countries, and indexes. Financial assets can be bought and sold freely through regulated exchanges or over the counter through private transactions involving a specialist dealer or broker. The beneficial ownership of a corporate vehicle operating as an investment fund is not necessarily the same as the beneficial ownership of the fund's underlying asset.

Investment funds can also hold complex financial instruments offered through derivatives markets, such as options, swaps, and futures. The pricing, risk, and terms of derivatives are based on an underlying asset, and they allow investors to hedge a position, increase leverage, or speculate on an asset's change in value.[12] For example, an investor might own both a stock and an option on the same stock that allows them to sell it at a set price; therefore, if the stock's price falls, the option still retains value, reducing the investor's losses. The increased use of derivatives has been a significant development in financial markets and can further complicate the identification of ultimate beneficial owners, as discussed below. Whilst considered, given the focus of this briefing on the BOT of corporate vehicles, a full treatment of the beneficial ownership of assets is outside its scope.

Intermediaries in investment funds

An investment fund serves as a conduit to benefit from one or more assets being held as investments. Investors can be individuals, corporate vehicles, or institutions, and there are usually a number of intermediaries between the investor and investment fund as well as between the investment fund and the underlying financial assets, especially if the fund's units are exchange-traded (Box 1). This creates complexity when determining who exercises ownership or control at various points in the chain, and who is ultimately benefiting from the fund's activities.

Depending on its legal form and structure, the individuals exercising control of an investment fund itself can differ from the individuals who own and benefit from the underlying assets being held by the fund at any given point in time, either directly or indirectly. Both retail and private investment funds typically have fund managers or advisors who make investment decisions for the fund, selecting securities that align with the fund's objectives and risk tolerance. They conduct research, analyse market conditions, and aim to make informed decisions to maximise the fund's performance. Reporting requirements vary, and fund managers may not need to be registered or licensed.

A single asset management company may oversee many investment funds. In this case, managers are typically employees who make decisions about the acquisition and disposal of assets in the funds for which they are responsible and who may benefit from a fund's performance, for example through a bonus. Managers typically use funds to trade securities or engage in other transactions through which financial assets may only be kept for a very brief period of time on investors' behalf, sometimes as little as a few seconds.

Box 1. Intermediaries involved in the management of investment funds[13]

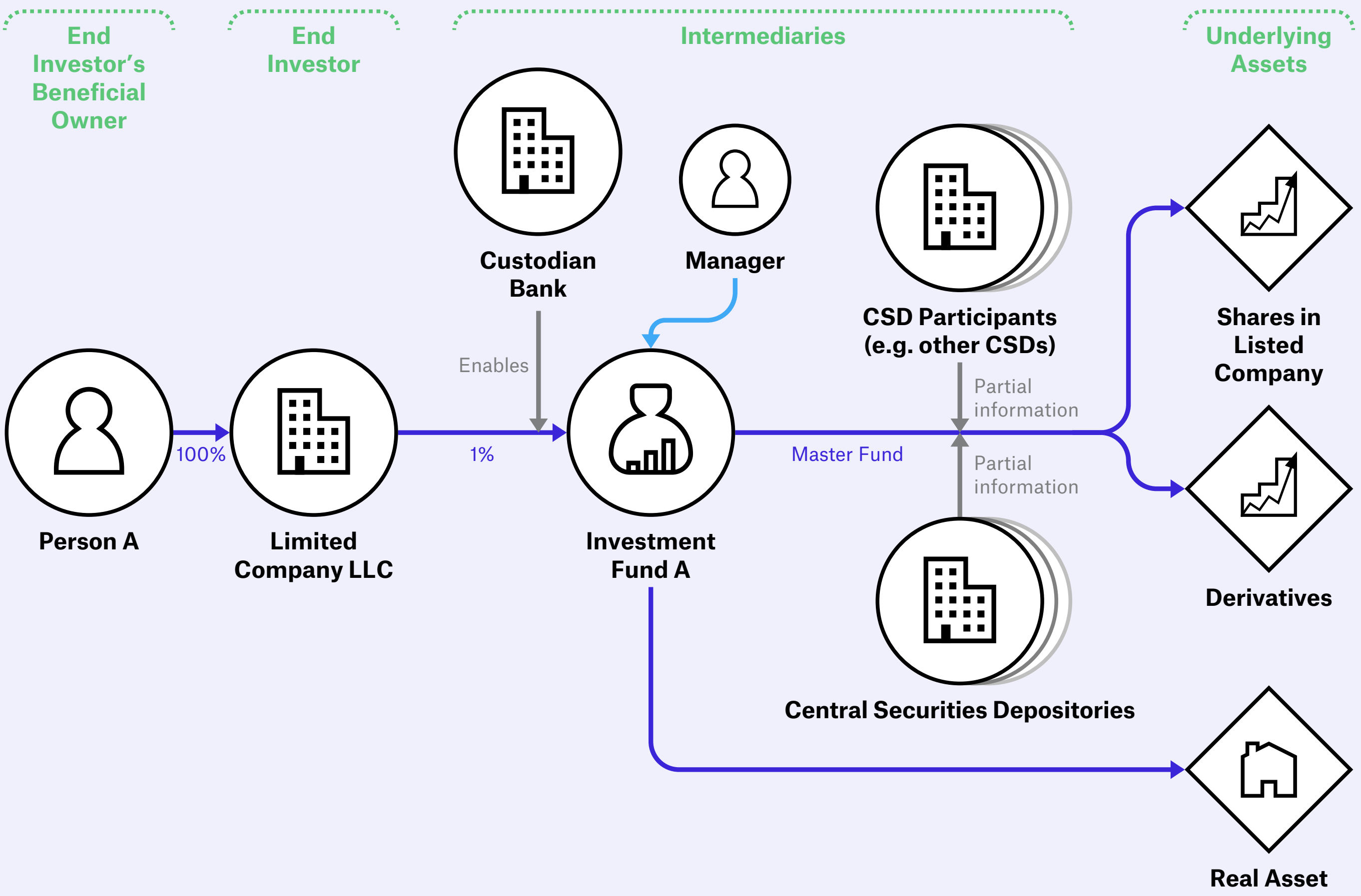
Brokers and dealers act as intermediaries between investors and the fund, facilitating the buying and selling of fund shares. They connect investors with the fund's shares and execute trades on their behalf.

Transfer agents manage the registration and transfer of fund shares, maintaining a record of shareholders, processing ownership changes, and issuing proxy materials for shareholder meetings.

Custodians act as a trusted third party, safeguarding the fund's assets, including stocks, bonds, and other securities. They maintain accurate records of the fund's holdings and ensure their safekeeping in a secure vault or depository. Often a bank, a custodian is the most likely actor to run checks on an investor's identity and the origin of their money; however, these checks may not extend to the beneficial owners, where the investor is a company.

Central securities depositories are specialised financial institutions or organisations that play a crucial role in the operation and management of traded investment funds, providing essential services that ensure the safekeeping, settlement, and transparency of securities transactions. They act as trusted intermediaries between investors, investment funds, and other market participants, facilitating efficient and secure investment activities.

Figure 1. Illustration of intermediaries' involvement in an investment fund and its financial assets



In Figure 1, Person A uses "Limited Company LLC", of which Person A is the sole beneficial owner, to hold an interest in Investment Fund A. Investment Fund A invests in real estate and financial assets in the form of derivatives and shares in a PLC. In the middle, different types of intermediaries are involved. A custodian bank allows Limited Company LLC to invest in Investment Fund A, and central securities depositories hold registers of the ownership of securities, including shares in PLCs and exchange-traded derivatives. Each of these intermediaries holds partial information about various parties in the chain and investment ownership, making it difficult for each of them to know the identity of Limited Company LLC's beneficial owners, the financial assets ultimately held by them, and all the intermediaries involved.

General legal and regulatory frameworks for investment funds

The investment industry is highly regulated in most countries. The existing regulations of the sector and securities trading are primarily intended to protect current and potential investors.[14] They ensure that investors are aware of the risks associated with their investments; help maintain the integrity of the market for investments and securities; and guard against fraud. Whether and how investment funds are subject to additional regulations, for example to combat money laundering, differs significantly between jurisdictions.

In some jurisdictions, the agency responsible for implementing laws and regulations governing investment funds is also responsible for implementing BOT. For example, the Securities and Exchange Commission of the Philippines is the national government regulatory agency charged with supervision over the corporate sector, including maintaining the country's central BO register. It also oversees "capital market participants, the securities and investment instruments market, and the protection of the investing public."[15]

Regulatory regimes in the United States and the European Union

The US has the largest investment fund industry in the world, with its managed fund assets amounting to around USD 32 trillion in 2022.[16] The EU follows with approximately USD 19 trillion under the management of investment funds, as of 2021.[17] In the US, the Investment Company Act of 1940 is the main legislation that imposes substantive requirements on investment funds' organisation and operation, and the US Securities and Exchange Commission (SEC) issues rules for the effective regulation and management of both retail and private investment funds. These rules are again mainly designed to protect investors by increasing transparency, integrity, competition, and efficiency in the investment and securities market. This includes measures such as requiring private fund advisers to provide quarterly statements to investors detailing certain information regarding fund fees, expenses, and performance, and obtaining and distributing to investors an annual financial statement audit of each private fund it advises.[18]

In the EU, the industry is mainly regulated by two Directives: the UCITS Directive and the Alternative Investment Funds Manager Directive (AIFMD).[19] The UCITS Directive covers mutual funds and lays down uniform rules, such as allowing for cross-border offerings as well as mandating certain information for investors to make it easier to understand the product in which they are investing. The AIFMD covers private (or alternative) investment funds, and lays down rules for authorising, supervising, and overseeing the managers of these funds. The bodies charged with implementing these Directives vary among member states and include, for example, securities and exchange regulators and tax agencies.

The US and the EU's AML requirements for investment funds differ significantly, with implications for their oversight. In 2015, the EU passed the fourth Anti-Money Laundering Directive, which considers investment firms a financial institution and therefore renders investment advisers subject to the same AML standards as banks and other reporting entities, including measures such as customer due diligence (CDD) checks. At the time of writing, a new AML package including the sixth Anti-Money Laundering Directive was being drafted, and will aim to ensure the consistent identification of beneficial owners of UCITS and alternative investment funds with or without a legal personality by introducing a harmonised definition.[20] In contrast, the US's AML regime, as set out in the Bank Secrecy Act, does not require investment advisers of private funds to maintain AML programmes. Several types of investment companies are also exempt, though AML requirements are in place for most retail funds.[21] At the time of writing, new rules were being contemplated in the US to strengthen AML requirements for private investment advisers (see Box 5).[22]

Misuse of investment funds

Given their involvement in such a significant share of the global economy, not knowing who ultimately owns, controls, or benefits from investment funds risks undermining a range of policy objectives that countries typically pursue through BOT. For example, investment funds have been associated with sanctions evasion[23] and threats to national security via public procurement contracts. In one case, the lack of disclosure of private funds obscured the fact that a majority stake in a US voting management firm in 2018 was owned by a Russian oligarch, calling into question election security.[24] BOI about investment funds is also collected for tax purposes via the Common Reporting Standard (CRS) for automatic exchange of information that is implemented by over 100 countries, though gaps in the framework exist.[25] Moreover, investment funds are a common means through which ownership and control are held in extractive industries, including in the mining of critical minerals for the energy transition.[26]

Finally, investment funds have been used to facilitate corruption. Their long-term outlook can make them attractive to corrupt, authoritarian rulers planning for decades-long rule.[27] For example, a former president of the Philippines is alleged to have earned around USD 400 million in investment interest on funds originating from stolen origins.[28] In Brazil, a settlement valued at over USD 3 billion was paid by two brothers involved in a corruption scandal in which an umbrella investment fund that owned and controlled the family business conglomerate was used for corruption payments to state-owned banks, illegal campaign donations, and bribes to a state-controlled pension fund.[29]

International AML standards are a key policy driver for BOT reforms, and most documented cases of misuse of investment funds involve money laundering and related financial crimes. There are several factors that contribute to the potential for misuse of investment funds relevant to BOT, including:[30]

- **The types of corporate vehicles used**: Although investment funds can be incorporated as companies, they are more often structured as trusts or limited partnerships; these types of corporate vehicles are often subject to different registration and BO disclosure requirements across jurisdictions than companies are.
- **The prevalence of indirect ownership, control, and benefit**: There are usually a number of intermediary actors and corporate vehicles between the investor and investment fund, as well as between the investment fund and the underlying financial assets.[31] This makes it difficult to identify the ultimate investor or beneficial owner of the assets being held as investments.
- **The fragmentation of information**: Due to the prevalence of intermediaries, each party holds only partial information about the full picture of ownership, control, and benefit, which adds layers of secrecy and complexity in identifying the ultimate investor or beneficial owner (see Box 1 above).

Financial institutions and other intermediaries are usually obliged to perform CDD and know-your-customer (KYC) checks under regulations for AML. However, AML regulations for private investment funds in particular are lacking in some jurisdictions. In addition, the trade secrecy practices underpinning the investment industry and securities trading may significantly undermine measures to address tax evasion, corruption, and money laundering. For example, omnibus accounts are commonly used to prevent other intermediaries or competitors from identifying investment funds' clients and stealing business. Finally, the complexity that arises from the involvement of various intermediaries makes it difficult for all stakeholders, including authorities such as law enforcement agencies, to obtain all the pieces of information necessary to create a complete picture.

Documented risks of misuse

Investment funds have recently been identified in a number of countries as a vehicle to launder the proceeds of crime. The documented risks of misuse to date point to private (or alternative) investment funds being riskier than retail funds. In the Netherlands, for instance, investment funds are included among the 15 greatest money laundering threats in its 2019 national risk assessment. The high money laundering risk rating of investment funds is mainly attributed to the use of unlicensed private investment funds, funds established outside the Netherlands, and limited knowledge and awareness of funds' misuse for money laundering.[32]

Similarly, in May 2020, the US Federal Bureau of Investigation (FBI) highlighted concerns that "threat actors", including "financially motivated criminals and foreign adversaries", are likely using private fund structures "to launder money, circumventing traditional [AML] programs".[33] It also emphasised that the AML compliance programs within the US private funds industry are not sufficient to effectively mitigate money laundering risk in the sector.[34] The US private investment industry alone was valued at USD 11 trillion in 2021, making it equivalent to the world's third largest economy.[35] It has proven to be attractive for both domestic and international illicit financial flows from the proceeds of drug trafficking, fraud, corruption, tax evasion, and other illegal activities.[36] The lack of AML obligations for real estate professionals could also be an exacerbating factor.[37] At the time of writing, new rules are being developed to counter money laundering risks from both investment funds and real estate in the US (see Box 5).

Case studies on the misuse of investment funds for money laundering and corruption have also been emerging from Latin America. For instance, a recent study has shown that family offices are increasingly being used in Brazil, the region's largest private investment market, to make investments abroad.[38] Family offices are relatively unregulated fund structures available in many jurisdictions that are primarily regarded as extensions of private individuals and a means of managing personal wealth without external investors.[39] Due to this, family offices are subject to lax regulatory oversight domestically in Brazil and internationally, including weak or non-existent AML and BO disclosure requirements, which reportedly resulted in their increased use for foreign investments in Brazil. The research also highlighted the involvement of investment firms, particularly in Canada, Switzerland, and the US, in laundering and investing illegal funds generated from drug trafficking, corruption, and fraud in Venezuela and other Latin American countries in international markets.[40]

Case studies

The following case studies detail multiple ways in which investment funds have allegedly been misused. First, investigative journalists have reported cases of private investment funds being used for money laundering by organised crime groups as well as to potentially cover up the use of dubious funds to invest in professional sports (Box 2 and Box 3). Second, investment funds have reportedly been used to amass and trade positions in shares of PLCs, allegedly to manipulate or artificially inflate share prices (Box 4). Finally, investment funds have been the target of civil forfeiture action due to their alleged receipt of funds originating in money laundering networks used for international drug trafficking (Box 5).

Box 2. Suspected money laundering through investments in gambling companies[41]

In 2017, a Dutch investment fund invested in a Malta-based gambling and betting company, which was active in Italy under a different name. The gambling and betting company appeared to be involved in an international money laundering network operating in the period 2015-2017 and was suspected of being run by the Italian organised crime group *Ndrangheta*. A successive investment of the Dutch investment fund in another gambling and betting company linked to the group resulted in the Italian authorities suspecting the owner and staff of the Dutch investment institution of being involved in money laundering. Beyond this case, between 2015 and 2019, *Ndrangheta* reportedly attracted approximately USD 1.6 billion in legitimate international investment from hedge funds, family offices, pension funds, and other market participants, including one of Europe's largest private banks, by selling private bonds backed by front companies embedded in Italy's health sector.[42]

Box 3. Potential misuse of investment funds to buy a football club using criminal proceeds[43]

In 2021, a professional enabler allegedly presented the use of investment funds to a team of undercover journalists as a solution for hiding the origin and owners of funds for purchasing football clubs in the UK. The scheme involved setting up an investment fund with 20 or 21 small companies as investors, each company being held in a separate trust and with a stake of 5% or less in the investment fund. The real owner would be hidden in a master trust behind the small investors. However, due to the small size of shareholding of each investment company, the name of the beneficial owner of these companies would not be required to be disclosed to the English Football League (EFL) or any registry or other authority. Journalists later reported that the EFL – which bans anyone with an unspent criminal conviction and a minimum 12 months' jail sentence from owning a football club – reviewed its owners' and directors' test following this revelation of misuse of investment funds.[44]

Box 4. Alleged misuse of investment funds to hide controversial shareholding in listed companies[45]

A report by investigative journalists alleged that an investment fund in Bermuda and two in Mauritius have been misused to amass and trade large positions in shares of one of the largest and most politically connected business conglomerates in India, which includes four PLCs. The report claimed that the Bermuda-based fund was used by two associates of a close relative of the group's founder to bypass rules for Indian companies that aim to prevent share price manipulation. According to the Indian stock market rules, promoters (as they are called in India) or corporate insiders are prohibited from owning more than 75% of shares in PLCs in order to prevent artificial share price inflation. As a member of the so-called promoter group, the family member's affiliation with the investors in the Bermuda-based fund is significant since their indirect control of the fund via these apparent nominees would constitute a violation of stock market regulations.

In this case, the two Mauritius-based investment funds have been alleged to be the fronts for the owners of the conglomerate and used exclusively to trade its stocks. Through the funds, the apparent nominees acting on behalf of the group's insiders were alleged to have secretly controlled between 8% to 14% of the shares available to be traded by the public in three of the four PLCs in the group in January 2017. These funds, including the Bermuda-based fund, have therefore been alleged to be indirectly controlled by the group and misused to manipulate or artificially inflate the share pricing.

Box 5. Settlement of civil forfeiture claims against millions laundered into real estate[46]

In January 2021, the settlement of a civil forfeiture action against over USD 50 million was announced in the US. The defendant was a Florida-based private investment company that had raised over USD 100 million to invest in real estate. From 2016 to 2019, the company or its subsidiaries allegedly received millions of dollars in criminal proceeds from investors as part of the investors' efforts to launder the funds via a black market currency exchange network. The network was reportedly allowing drug trafficking organisations to transfer narcotics proceeds from the US to the country in which they operated, concealing the nature of the funds.

Throughout 2018, the US Drug Enforcement Administration used undercover accounts to transfer millions worth of narcotics proceeds to subsidiaries of the company at the instruction of money-laundering brokers. The company accepted these funds without inquiring about their source. In addition, millions of dollars of criminal proceeds were used to fund other investments in the company. The company reportedly ignored red flags for those investments, including discrepancies between the purported investment amount and the actual amount the company received, as well as discrepancies between the purported investors and the entities sending the funds. The defendant company and 31 of its subsidiaries agreed to forfeit USD 29 million in the settlement. It also agreed to conduct reasonable due diligence on future investors, and not to accept funds from apparent nominees but only from the actual investor.

Policy and regulatory framework on the beneficial ownership transparency of investment funds

The cases above suggest that regulatory requirements may be falling short of effectively mitigating the risks of investment funds becoming instruments for financial crime and other forms of misuse. The question remains as to whether current BOT requirements for investment funds are appropriate: firstly, to understand how they are owned, controlled, and used to derive benefit; and secondly, to help prevent their misuse, as part of the broader regulatory framework. There is a need to better identify weaknesses in the BOT framework set out by current international standards that could be exploited by criminals. To address these issues, this section considers how well international standards apply to investment funds, and assesses whether current frameworks on BOT for investment funds are appropriate and adequate, and how they can complement broader regulatory frameworks.

Applying internationally established definitions of beneficial ownership to investment funds

International standards do not contain a specific definition of beneficial owners of investment funds. Therefore, it is important to understand how the notion of beneficial ownership should be applied to investment funds, which enable natural persons to own, control, and benefit from assets. This lack of a standard definition is potentially due to the fact that BOT reforms have so far largely focused on limited liability companies, and this focus has shaped the legal definitions that have emerged to best fit their mould. However, as BOT is being applied to an increasing number of corporate vehicles, there is a need to constantly reassess what BO means as a substantive concept when applied to other entities and arrangements, such as trusts, state-owned enterprises (SOEs), PLCs, and investment funds.[47]

The FATF is the global standard-setting body for AML, including for the disclosure of BOI. Many jurisdictions take the FATF's Recommendations into consideration when legislating for and defining beneficial ownership. The definition recommended by the FATF can be taken as a useful working hypothesis for understanding what beneficial ownership may look like in a particular jurisdiction and how it can be applied to investment funds. As discussed, investment funds can be organised in a variety of legal forms. To identify reportable beneficial owners of investment funds under the definitions set out by the FATF, the first consideration is whether a fund is a legal entity or arrangement.

Beyond the FATF, institutions such as the World Bank point to the need to consider a broad, substantive definition and adopt an open-minded approach that takes all economic realities into account when setting out and applying the definition of beneficial ownership, as well as a variety of potential policy aims.[48] Therefore, this section also considers how to treat investment funds under a broader, substantive definition of beneficial ownership that includes the concept of benefiting from corporate vehicles. Certain countries have already included being able to benefit from corporate vehicles in their definition. Some civil society organisations have argued that the concept of "benefitting from" should be included explicitly as a third prong in the definition of beneficial ownership in international standards, including AML standards.[49]

Investment funds organised as legal entities

Legal entities, referred to as legal persons by the FATF, are corporate vehicles with a separate legal personality. This means a legal entity can do many of the things a natural person can do in law in its own name, such as owning assets, entering into contracts, and acquiring debt. Forms of companies, such as corporations and limited liability companies, are the most common type of legal entities.

In countries where limited partnerships – or other forms of partnerships that may be used for investment – have a separate legal personality, the considerations for how to apply the definition of the beneficial ownership of legal entities will also be applicable to investment funds organised in this way.

According to the FATF recommendations, "in the context of legal persons, 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 natural persons who exercise ultimate effective control over a legal person".[50] BOI should be collected in a government register as well as by obliged entities, such as banks and financial service providers, which are also required to identify and verify the identity of the beneficial owners of a legal person as part of their CDD.

The FATF provides guidance for actors conducting CDD to apply a three-step or cascading approach, which is instructive in nature, to identify the beneficial owners of a legal entity in practice: first, by identifying any natural person(s) with a controlling ownership interest; second, if the ownership interest is so diversified that there are no natural persons exercising control in this manner, by reporting natural persons exercising control of the entity through other means; and third, where no natural person is identified via the above means, by identifying the relevant natural person who holds the position of senior managing official.[51] The cascading approach is seen as less comprehensive than BO definitions for disclosure to central registers because if the party conducting CDD identifies individuals under the first test, there is no obligation to continue unless they have doubts after the first step, thereby some beneficial owners may not be reported.

Take the example of UCITS or other commercially available retail funds. One of the key features of these funds is a large distribution network that often extends across borders, making it possible for a very large number of natural persons to hold their units as investments. These persons are all benefitting from the fund, but in many cases they are unlikely to qualify as reportable beneficial owners under a legal definition based on AML standards. This is for several reasons:

- First, it may be difficult to find investors holding a **percentage of shares** in such funds that exceed the jurisdiction's legal threshold for reportable beneficial ownership. A commonly used threshold is 25% or more of share ownership or voting rights,[52] but shareholding in retail funds is usually very small, for instance down to fractions of a percentage. In addition, due to the presence of intermediaries (see Box 1), it may not be feasible to establish the aggregate ownership of a single beneficial owner through multiple shareholdings.
- Second, the ownership of a fund can change intraday, with the aggregate levels of percentage ownership potentially changing through no action of a given investor, but through other investors subscribing or redeeming their holdings and thus changing the percentages held by all parties. It will be challenging and impractical to track such **passive changes in beneficial ownership** held by each shareholder in both absolute and relative terms, let alone to track such changes through to an intermediary's customer.
- Third, it may not be appropriate or practical to consider natural persons holding only a few shares of a UCITS or other commercial fund via an intermediary to be reportable beneficial owners. The underlying customers of the intermediary – the investors in the fund – have no direct relationship with the investment fund, which makes it **infeasible for them to have a controlling ownership or significant influence** over the daily activities of a fund.

Due to these factors, if the standard CDD approach is applied, it will likely result in the failure to identify any natural person with significant ownership or control held via investment interests. Instead, it would most often identify fund managers, being senior officials, as beneficial owners. The manager's identity may also be on record via other regulatory obligations, for instance as an authorised signatory, approved person, or director. Therefore, **beyond identifying fund managers, applying a standard CDD approach may not lead to the identification of any beneficial owners of investment funds organised as legal entities**.

This presents a challenge for covering investment funds in central registers because in many countries senior officials may be explicitly excluded from the definition of the beneficial ownership of legal entities for the purposes of disclosure to a central register. As a result, it is highly likely that central BO registers requiring investment funds to register their beneficial owners find that no one is identified or registered as such. This can be observed in established BO registers that include BO declarations on corporate vehicles operating as investment funds, for instance in Luxembourg (Box 6).

Box 6. Undeclared beneficial owners of investment funds – Luxembourg

Luxembourg's BOT regime covers a wide range of corporate vehicles that facilitate the ownership and control of assets within its scope. The Luxembourg Register of Beneficial Owners (*Registre des Bénéficiaires Effectifs*, or RBE) requires all entities that are registered with the Luxembourg Trade and Companies Register (*Registre de Commerce et des Sociétés*, or RCS) to disclose and regularly update information on their beneficial owners. This encompasses companies and partnerships, whether regulated or not, including Luxembourg investment funds such as UCITS and other types of alternative investment funds.[53]

Luxembourg is home to the largest number of investment funds in Europe, the second largest in the world after the US. Despite the requirement for investment funds to disclose their BOI to the RBE, a report published by Transparency International noted that 81% of the 16,777 investment funds registered did not declare any beneficial owners.[54] The report notes that this is most likely due to their inability to identify any beneficial owners according to Luxembourg's statutes.

The legal definition is taken from the amended law of 12 November 2004 on the fight against money laundering and terrorism financing, which defines a beneficial owner as "any natural person who ultimately owns or controls the customer or any natural person on whose behalf a transaction or activity is being conducted".[55] It is, in other words, identical to the FATF recommendations as well as being aligned to the EU's 5th Anti-money Laundering Directive, and is not tailored to investment funds. The report recommends that the register takes steps to review the definition to ensure that "all beneficiaries of investment funds – the real natural persons who are the end-investors – are accurately identified, disclosed and recorded in the [RBE]".[56]

Investment funds organised as legal arrangements

Parties can establish legal arrangements to govern their relationship in pursuit of a common purpose or to create rights and obligations with respect to specified assets. A trust is a legal arrangement typical to common law systems and has uses including creating a fiduciary obligation and oversight when transferring assets, for example, for estate planning or charitable donations.[57] Arrangements do not typically have a separate legal personality.[58]

For trusts or similar arrangements, international standards, including the FATF, define all parties, that is, settlor(s), trustee(s), protector(s), (likely) beneficiaries – including any individual that exercises significant control, or is likely to benefit – as beneficial owners.[59] For other arrangements similar to trusts, this includes the natural person(s) holding equivalent or similar positions, as in trusts.[60]

This approach of identifying all parties as beneficial owners has been taken particularly due to the flexibility and opacity of legal arrangements, which sometimes make it difficult to establish who benefits from or exercises control over an arrangement. In jurisdictions where investment funds are organised as arrangements, this FATF definition **could lead to comprehensively identifying all parties who own, control, and benefit from investment funds**.[61]

For example, private investment funds are usually arranged in the form of limited partnerships or trusts. In these cases, one party is generally in charge of managing the fund (e.g. a general partner or a trustee), whilst investors (e.g. limited partners, or settlors and beneficiaries) provide funds for investment without having day-to-day control over the investment and other decision making. If limited partnerships and trusts are not considered legal entities in a jurisdiction, the definition of the beneficial ownership of trusts and other legal arrangements could be applied to a private investment fund: identifying all the parties as beneficial owners.

However, this is dependent on whether a regime's disclosure requirements comprehensively cover all forms of arrangements, including domestic and foreign trusts, limited partnerships, and trust-like arrangements, as discussed below. It also depends on whether any thresholds are adopted based on interests held in the trust, as has been done in the Republic of Ireland (Box 7).

Box 7. Coverage of investment funds in the EU – Republic of Ireland

In Ireland, the Statutory Instrument No. 233/2020 on the Registration of Beneficial Ownership of Certain Financial Vehicles Regulations 2020[62] (hereinafter the "Regulations") applies BO disclosure requirements, with some exceptions, to an "applicable financial vehicle", which is defined as including an Irish Collective Asset-Management Vehicle (ICAV) and an investment fund established as a unit trust. Generally, a unit trust is a type of investment vehicle that pools money from multiple investors to invest in a diversified portfolio of stocks, bonds, or other securities. Investors receive units or shares in the unit trust that represent their proportional ownership in the fund. The value of these units may fluctuate based on the performance of the underlying assets.[63] Both ICAVs and unit trust funds are required to file their BOI with the Central Bank of Ireland (as registrar) for inclusion on the Register of Beneficial Ownership of Certain Financial Vehicles.

With regards to unit trust funds, the Regulations prescribe a threshold for the purposes of identifying a beneficial owner. According to the Regulations, a beneficial owner of a financial vehicle that is a unit trust (which also covers UCITS within its scope) is: a natural person who owns or is ultimately entitled to control more than 25% of the units in the trust; or any other natural person exercising ultimate control of the trust by direct or indirect ownership, or by other means, which includes trustee and settlor. The requirement to include the details of senior managing officials (such as directors of the management company) where no beneficial owner can be identified does not apply to unit trust funds.

Although the Republic of Ireland has covered investment funds within the scope of its BOT regime to comply with the EU's 5th Anti-money Laundering Directive, it is highly unlikely that anyone would be identified and reported as beneficial owner(s) of such funds (whether ICAV or unit trusts) by meeting the required threshold of more than 25%, as discussed above, or by being a natural person(s) exercising control over the trust by other means. In the case of Ireland, the Regulations also appear to have limited the meaning of "control by other means" to the identification of a trustee and settlor whilst excluding beneficiaries or class of beneficiaries from within the scope of this definition.

Including deriving benefit in the definition of beneficial ownership

Incorporating the concept of deriving benefit into legal definitions for the beneficial ownership of legal entities, rather than considering only ownership and control, may strengthen how definitions can be practically applied to investment funds. As Transparency International notes, "the very concept of an investment fund provides that the individuals investing in the fund and financially benefiting from it are not the same as those controlling the fund and making decisions on the types of investments, among others".[64] The FATF does not explicitly include deriving economic benefit as one of the criteria to identify a beneficial owner of legal entities. In jurisdictions that opt for a narrow interpretation of this definition in their legislation, it is unlikely that investment funds will identify any individuals that meet these criteria as beneficial owners (see Box 7).

Some experts have argued that interpreting the FATF recommendations to include a natural person who benefits from a legal person in a jurisdiction's BO definition is consistent with their language and purpose, and reflects a more holistic approach to their application in national legislation.[65] Failing to include deriving economic benefit leaves a gap in BO reporting frameworks that can be exploited, for example, enabling criminal organisations to benefit from capital gains on illicit funds via professionally managed investment funds. Therefore, remaining bound to a literal definition based on the FATF requirements is likely to be insufficient to achieve a number of policy aims, including AML, if no information is captured through complementary regulatory measures.

Furthermore, the concept of "benefitting from" is clearly included in the definition of beneficial ownership for legal arrangements, as beneficiaries are considered beneficial owners. As trusts can be run as businesses, and companies can also be primarily family affairs, many argue for parity between entities and arrangements, and to simply treat both under the umbrella term "corporate vehicles".[66]

Several jurisdictions have already used a definition of beneficial ownership for legal entities that explicitly includes the concept of benefit within its scope. Countries such as Colombia, Czech Republic, El Salvador, Ghana, India, Indonesia, Japan, the Netherlands, and Slovakia have provided that beneficial owners include individual(s) who have rights to economic benefit from an entity. In these cases, the ability to benefit from a corporate vehicle is not necessarily tied to ownership of shares. It can include, for example, receipt of dividends, profits, and enjoyment of assets.

A provision like Ghana's which includes the enjoyment of direct and indirect benefit outside of shareholding may allow implementers to capture a fuller picture of ownership and benefit in investment funds and other corporate vehicles (Box 8). It may also help prevent disclosure avoidance through the decoupling of ownership and voting rights, which is discussed below. There is also precedent in the definition of beneficial ownership as applied to PLCs, where the main focus has typically been on enjoyment of economic benefit rather than on control.[67]

Box 8. Legal definition including the derivation of benefit – Ghana

The Ghana Companies Act of 2019 includes the receipt of substantial economic benefits in its definition:

"'beneficial owner' means an individual

(a) who directly or indirectly ultimately owns or exercises substantial control over a person or company;

(b) who has a substantial economic interest in or receives substantial economic benefits from a company whether acting alone or together with other persons;

(c) on whose behalf a transaction is conducted; or

(d) who exercises significant control or influence over a legal person or legal arrangement through a formal or informal agreement"[68]

Are beneficial ownership transparency requirements for investment funds sufficient?

As the discussion on applying international standards for the definition of beneficial ownership suggests, current BOT requirements fall short of effectively capturing information on who ultimately owns, controls, and benefits from investment funds through those requirements. They may be insufficient to ensure effective transparency and oversight of investment funds for several reasons, as outlined below.

Thresholds in existing definitions may create a reporting gap

Common thresholds used in BO definitions for entities will likely result in a gap in the BO disclosure requirements for investment funds that could be exploited. This risk seems especially acute for private investment funds. For instance, a number of small private investment companies might be established to hold less than the prescribed threshold in an investment fund to avoid becoming reportable beneficial owners. To make the structure more complex, these investment companies might all be controlled by a master trust controlled by a criminal, however, due to the involvement of various intermediaries in the process, it will be difficult to determine this indirect ownership or control via other means. Although this is a common tactic recognised among all legal entities to avoid detection in the failure to disclose, it becomes even more challenging in the case of investment funds due to their shareholdings being particularly small and their use of intermediaries.

One strategy could be to use a risk-based approach to setting thresholds, such as analysing a corporate vehicle's turnover or assets under management and setting differential thresholds in which the higher the value, the lower the percentage reporting threshold becomes. Lower thresholds are commonly recommended in cases where corporate vehicles that are higher risk, such as those operating in the extractives sector,[69] and are used for PLCs.[70] The US Treasury Department's Financial Crimes Enforcement Network (FinCEN) has considered an approach along these lines for AML requirements for investment funds, which contemplates requiring registered investment advisers with more than USD 100 million in assets under management (who are not subject to other exemptions) to establish AML programmes, and that they begin submitting suspicious activity reports (SARs) to law enforcement and establish certain recordkeeping and reporting practices.[71] Whilst this approach targets CDD regulations, it could also be applied to BO disclosure to a central register. CDD measures for investment funds could also form part of a broader regulatory approach.

Reporting senior managers is part of but does not replace full beneficial ownership information

In the context of AML standards, if no natural person is identified as the beneficial owner of an investment fund through ownership and control (e.g. via voting rights), senior managing officials may then be identified and reported as beneficial owners, since they have control over the management of the fund. This approach has been adopted by certain central registers. For example, in Denmark the BO guidance provides that if an investment fund has no beneficial owners or no beneficial owners are identified by applying the legal definition of beneficial ownership, the members of the investment fund's board of directors or management must be recorded as beneficial owners with the Danish Business Authority.[72]

Moreover, there is an argument for always including fund managers in BO disclosures for investment funds, even where other beneficial owners are also identified, due to their unique control relationship to these corporate vehicles. This is consistent with recommendations about how to effectively implement BOT for SOEs. In any SOE, it is always recommended to capture information about the state or state agency involved in its management, in addition to the usual information required about natural persons, to be able to comprehensively understand their ownership and control.[73]

Since many jurisdictions explicitly exclude senior management from the definitions of the beneficial ownership of legal entities obliged to report to a central register, it may be necessary to create a BO definition specifically for investment funds in primary or secondary legislation that allows them to be reported. This measure can be considered alongside registration requirements. For example, all funds could be required to have a licensed or registered management professional and reference to the location of this information made in the BO register. Or, where permitted, disclosures of the fund manager could apply to the BO register if they are unregistered or unlicensed (see Box 10).

However, the identification of only senior officials as beneficial owners may defeat the purpose of identifying who ultimately owns or controls an investment fund for many policy aims. Therefore, whilst practical, this approach should be used only after the legal definition of beneficial ownership – as specified in international standards – is reconsidered and ideally made fit for the purpose of investment funds in each jurisdiction's context. To ensure that BOI is not limited to senior managers, it may be necessary to lower the threshold, to incorporate the concept of "benefitting from" into the BO definition, or both. However, this should be balanced against the practical considerations that can complicate BO reporting for investment funds and existing disclosure requirements.

For instance, documented cases suggest that the risk of misuse of retail funds, such as mutual funds, is lower than that of private funds, regardless of their form of incorporation. Setting very low thresholds to identify a large number of beneficial owners of a retail fund based on controlling ownership and benefit by a fund's investors may therefore have limited utility in mitigating risks of misuse. Other mechanisms such as SARs and KYC/CDD checks by obliged entities may be as effective for AML oversight, for example to detect whether the bank account a customer uses to invest in a commercial contains funds from questionable origins. In contrast, given higher risk of misuse among private funds, making all parties of such funds reportable as beneficial owners may be a more straightforward and proportionate solution.

Separating ownership, benefit, and control creates ambiguity

Corporate law historically made voting power proportional to economic ownership. The core principle is that when economic power equates voting power, it will naturally lead to the best possible decisions being made to secure or optimise a shareholder's economic interests.[74] However, certain mechanisms now allow for the separation of ownership from control, especially voting rights. Arguably, the ability to separate certain rights traditionally associated with ownership of corporate vehicles is something that BOT aims to provide better visibility over. This is a consideration for developing a substantive definition of beneficial ownership that includes deriving benefit, and is relevant for investment funds.

The phenomenon of separating ownership from control has been referred to as morphable ownership. It has in the past allowed for the avoidance of large shareholder disclosures and has affected takeover battles and control of public companies in multiple countries.[75] It is less clear whether morphable ownership through investment funds is being used to avoid BO disclosures to central registers, but it is possible; more research is needed. Financial interest can be severed from legal ownership through means of arrangements, such as loan agreements, call option agreements, pledge agreements, licensing agreements, and power of attorney. These commercial transactions are often confidential and are prime examples of instruments that can be exploited for ownership fronting: the undisclosed or unlawful use of a nominee in place of a true ultimate beneficial owner.

This precedent in corporate law may also help explain the reasoning behind the FATF's tiered approach for determining beneficial owners of legal entities in CDD: the first is any natural person(s) with a controlling ownership interest, and the remaining tiers continue to focus on control, whilst eschewing other forms of financial interest that allow for deriving benefit. It also points to why a definition based on global AML standards can fall short when applied to investment funds, which offer a means by which significant economic benefit can be enjoyed without a natural person maintaining direct control over investment decisions.

Hedge funds, a type of private investment fund, are a key example. Derivative markets have made it possible for investors in hedge funds to separate the ownership and voting interest attached to shares between multiple individuals or institutions. For example, two actors may use a swap to shift the voting rights attached to certain shares to one investor, whilst the original shareholder maintains economic benefit. In this situation, the investor is essentially borrowing the voting rights, whilst the person holding the economic benefit could avoid being identified under CDD checks as a beneficial owner because they do not actively have control.[76] Similarly, the frequent use of the limited partnership form for investment funds is in part due to the ability to have limited partners who are passive investors receiving benefit without exercising control, the arrangement of which depends upon the partnership's specific contract.

The regulation of derivatives has tightened to some extent since the 2008 financial crisis. For example, it led to the introduction of Swap Execution Facilities in the US, which allow for transparency and provide records and auditable trails of trades.[77] However, such facilities and other regulations are not universal in either the US nor other countries, and more research is needed to better understand how these facilities are or can be used, if at all, in policy areas relevant to BOT, including AML.

Some corporate vehicles may have no disclosure requirements

Whilst most legal entities are covered by BO disclosure requirements in most jurisdictions, a lack of disclosure requirements for legal arrangements may hinder reporting for some investment funds, making them implicitly but not explicitly exempt. For instance, in a number of jurisdictions trusts are considered private arrangements that are not required to be registered with any authority to be legally recognised, unlike companies. Even if they are required to register, the level of information required to be disclosed does not always extend to complete BOI.[78]

Similarly, in the case of investment funds that are organised as limited partnerships, a lack of existing disclosure requirements could be an issue, especially for those jurisdictions where the BO disclosure requirements do not apply to all types of corporate vehicles. Experience in the UK implies that an investment fund that is organised as a limited partnership in a country where some or all limited partnerships do not have a separate legal personality, there may be no requirement to disclose beneficial owners of an investment fund to the BO register. Even in countries where limited partnerships are required to disclose their beneficial owners, there can be gaps in who is disclosed (Box 9).

Box 9. Coverage and reporting obligations for limited partnerships – United Kingdom

In the UK, Scottish Limited Partnerships (SLPs) have a separate legal personality whereas this is not the case for English Limited Partnerships (ELPs). Although both SLPs and ELPs are required to be registered with the Registrar (Companies House) to come into existence, only SLPs are required to disclose their BOI on the central register, the People with Significant Control (PSC) Register. Moreover, in the PSC Register, only general partners of a limited partnership fund vehicle organised as a SLP are required to be registered, and limited partners are only required to be registered if they exercise significant influence or control in their own right, i.e. the enjoyment of benefit does not lead them to being reportable beneficial owners.

In the PSC register, it has been identified that in several instances either intermediaries, such as banks or other companies in the ownership chain that qualify as a "Relevant Legal Entity",[79] are registered as beneficial owners of investment funds rather than the natural person(s), or no beneficial owners are stated to be identified.[80] The UK tax authority considers assets in funds held by the general partner on behalf of the partnership as held on trust. Therefore, investment funds set up as limited partnerships may be deemed registrable – including the disclosure of their beneficial ownership – to the Trust Registration Service.[81]

Some beneficial ownership disclosure regimes specifically exempt investment funds

A number of countries exempt some or all investment funds from disclosing their BOI to a central register. Many countries treat investment funds in the same way as PLCs for the same public policy reason that there should be a regulator maintaining equivalent information that would be adequate, accurate, and up to date, and that is readily available, when required.[82] However, before taking a decision as to whether or not to grant an exemption to any type of investment funds from BO disclosure requirements, the question of whether existing transparency and reporting requirements are adequate for understanding ownership, control, and derivation of benefit, and what this is intended to be used for, should be considered. For instance, in the US, certain investment funds are exempt from BO disclosure requirements provided they are operated or advised, for example, by a SEC-registered broker-dealer, a SEC-registered investment company, or a SEC-registered investment adviser (Box 10).

Box 10. Beneficial ownership disclosure exemptions for private investment funds – United States

In September 2022, FinCEN issued its first of three final rules (hereafter, the "Final Rules") implementing the Corporate Transparency Act's (CTA) requirements to report BOI to FinCEN. The Final Rules have important implications for private investment funds depending on how they are structured, including reporting their BOI to FinCEN. Private fund managers must assess their compliance and reporting requirements under the Final Rules for all the funds they advise. The impact of these rules varies based on factors such as a fund manager's SEC-registration status, their location, and the type and location of the funds they manage.

In the context of funds, a fund manager (whether an individual or a legal entity) registered with the SEC may be exempt, whilst the fund itself may or may not be. Exemptions apply to funds operated or advised by a bank, Federal or state credit union, SEC-registered broker-dealer, SEC-registered investment company or investment adviser, or venture capital fund adviser. It is worth noting that FinCEN did not create a blanket exemption for state-registered investment advisers. If the fund manager is not SEC-registered and is relying on exemptions like those for private fund advisers, foreign private advisers, or family offices under the Advisers Act, they will not be exempt entities under the CTA requirements.

Moreover, it is possible for a fund manager and the fund to be exempt, whilst the portfolio companies in which the fund invests are not exempt. Portfolio companies wholly owned or controlled by a pooled investment vehicle do not qualify for the subsidiary exemption. Whilst this exemption applies to wholly owned subsidiaries of registered investment companies, it generally does not apply to subsidiaries of private investment funds. Therefore, certain entities, such as blocker entities, feeder fund entities, and similar private investment vehicles are likely to be subject to the CTA reporting requirements.

Private investment funds advised by a registered investment adviser and relying on specific exceptions (i.e. the Section 3(c)(1) or 3(c)(7)) under the Investment Company Act may be exempt, but their subsidiaries may not be. Additionally, if a private investment fund is a real estate vehicle relying on Section 3(c)(5)(c) of the Investment Company Act, it may not be exempt. Finally, fund managers and venture capital firms should include research on beneficial owner reports filed or exemptions claimed by any potential portfolio company investment as part of any diligence process. Once an investment is made, relevant updates must also be filed in a timely manner.

Whilst these exemptions may seem to be reasonable, it is important for policymakers to first determine the extent to which they provide for adequate oversight to achieve the jurisdiction's policy objectives(s). Consideration should be given to whether BO data about certain investment funds is already available and reasonably accessible from other sources, such as regulated stock exchanges. For example, in the case of investment funds listed on recognised stock exchanges, some of the relevant questions that need to be asked include: what BOI is available from these stock exchanges; how easily this information is accessible; whether the information is kept up to date; and whether the available information is sufficient or adequate to identify beneficial owners.[83]

Furthermore, it is important to determine the extent to which registered investment brokers, companies, or advisors are effectively supervised and monitored in a jurisdiction to ensure that they are complying with their required obligations, including obtaining and maintaining adequate, accurate, and up-to-date BOI. As discussed in this paper, there have been recent cases where investment companies have been involved in hiding the origin of illicit funds and their beneficial owners.[84] Where a fund is buying or selling assets over the counter rather than through regulated exchanges, the risks may be higher, as there are likely to be fewer and less standardised reporting requirements in place.

Finally, as noted above, certain types of investment funds, such as private investment funds that involve a smaller number of investors and often high-net-worth individuals, might be assessed by a country as being more of a risk compared to other types, such as mutual funds. They may also be less subject to oversight under existing AML frameworks. This higher risk related to private investment funds has also been identified in this paper based on the documented cases of misuse of investment funds.

Policy considerations

This section provides some summary considerations for policymakers and agencies implementing BO disclosure on how investment funds should be treated within BOT regimes. The following measures are recommended in alignment with the Open Ownership Principles for effective implementation of beneficial ownership disclosure.[85] However, further research into this complicated area of BOT reform is still needed. For instance, the relationship between effective BO disclosure for investment funds and PLCs, and the risks and regulations associated with less formalised investment structures such as rotating savings and credit associations, should be better understood.

Definition and thresholds for beneficial ownership of investment funds

The beneficial owners of an investment fund can include any individual (i.e. natural person) who ultimately owns, controls, or benefits from it. A jurisdiction may create a specific definition and disclosure procedure for investment funds, as has been done in Ireland, though it is recommended that this information be accessible via a central BO register. If not, the definition of either the beneficial ownership of legal entities or arrangements can be applied depending upon the legal form of an investment fund, whilst ensuring that all beneficial owners are accurately identified and disclosed to the BO register. In either case, a harmonised definition should exist across legislation to, for example, prevent false-positives when banks use information from a BO register alongside BOI they collect under AML obligations to perform discrepancy reporting.[86]

In the case of investment funds arranged as legal entities, the following key considerations apply:

a. Explicitly including the concept of deriving economic benefit in the legal definition of beneficial ownership of entities to ensure individuals with substantial financial interests in a fund are captured regardless of their level of control.

b. Allowing for the reporting of senior managing officials as beneficial owners of an investment fund to a central register when they exercise control over the fund, and requiring information about fund managers to be captured in most or all cases. However, this should be supplementary to, not reported in place of, complete information on beneficial owners.

c. If a manager is officially licensed and registered with another body, a reference to the location of this information may be adequate in a BO register rather than a full disclosure.

In the case of investment funds that are legal arrangements, all natural persons who are parties to the arrangement can be beneficial owners, e.g. settlors, trustees, protectors, beneficiaries or class of beneficiaries, and natural persons exercising effective control, including the fund manager. Where a legal entity is party to the arrangement, identifying its ultimate beneficial owners should form part of a fund's BO disclosure.

For both entities and arrangements, any thresholds that are used to determine ownership or benefit in the case of investment funds should be lowered, for example to 5%. Due to their nature and operation, higher thresholds, such as 25% or more, are likely to result in no one being identified and reported as a beneficial owner, including those who may derive substantial economic benefit. Differential or absolute thresholds based on factors such as risk and turnover could also be considered.

Coverage of the beneficial ownership transparency regime and the granting of exemptions to investment funds

Blanket exemptions should not be applied to investment funds, due to the documented risk of their misuse. Moreover, an exemption should not be granted unless reasonable, given an assessment of the sufficiency and effectiveness of existing disclosure and transparency requirements for investment funds, according to a jurisdiction's policy aims. To ensure the comprehensive coverage of all corporate vehicles that can serve as a legal form for investment funds, and any parties to these funds, countries may implement the following to enhance their BOT regime:

- covering all categories of corporate vehicles, including investment funds, regardless of their legal form, that facilitate the ownership and control of assets within the BO disclosure requirements, unless reasonably exempt;
- if any exemptions are to be granted, justifying them against policy aims, and reassessing them on an ongoing basis; and
- considering relative levels of risk between types of investment funds in creating disclosure requirements, with a particular emphasis on ensuring BO disclosure for private funds. However, the potential displacement of risk from corporate vehicles that are obliged to disclose beneficial ownership to those that are not should also be considered.

When a third party is carrying out oversight of investment funds outside a BO register and publishes relevant information on ownership, control, and benefit, such as a stock exchange, this can serve as a reasonable basis for exemption. Linking to such information should be an essential component of justifying the basis for the exemption. When granting exemption, it is also important to evaluate any challenges that may exist in obtaining the BOI. These challenges could arise from the format or structure of the data or from any limitations on access to the information.

Information to be collected from investment funds

Disclosure requirements for investment funds that are not exempt should align with the purpose of existing requirements for other covered corporate vehicles and be proportionate to policy aims. BOI should be collected from an authorised person or fund manager responsible for making such a disclosure to the BO register.

Whether or not full BOI is available, it is important to accurately capture relationships between investment funds and other entities, as well as between corporate vehicles within an investment fund structure, to gain a picture of the full network of ownership. For example, the Global Legal Entity Identifier System (GLEIS) allows for the capturing of the following fund-entity relationships:[87] umbrella structures, master-feeder, and fund management entities. Applying such data standards globally helps ensure that data is easily interpretable and interoperable across jurisdictions.

Investment funds that are not exempt

For investment funds that are not exempt from the BOT regime, information should be collected in line with existing standards for other legal entities and arrangements, such as name, business address, date of incorporation or formation, and any relevant organisational identifiers. Full information on beneficial owners should be also collected in a structured and machine-readable format, including:

- sufficient details about beneficial owners and corporate vehicles to be able to identify them unambiguously, e.g. full name, date of birth, and reliable identifiers;
- the nature of ownership, control, or economic interest; their extent, including whether the interest is held directly or indirectly; and in the case of trusts or similar legal arrangements, their roles in the trust or arrangement; and
- in the case of indirect interest, the means through which ownership or control is held or benefit is derived.

Exempt investment funds

Although full disclosure might not be required, exempt investment funds should be subject to minimum reporting requirements to ensure that they are identifiable on a BO register. The disclosure by exempt investment funds should include sufficient details to be able to unambiguously identify the investment vehicle. Moreover, exempt funds should be required to confirm their exemption status on a regular basis, for instance annually, and confirm the following information:

- detailed identifying information on an approved person, investment advisor, or a fund manager who is managing, arranging, administering, operating, or promoting an investment fund, including any relevant details under local regulations, such as a registration number;
- the basis on which the investment fund is eligible for exemption from BO disclosure requirements; and
- if an investment fund is exempt on the grounds that it is registered on a recognised stock exchange or other alternative mechanism, details of and an access link to the recognised exchange listing or other source of BOI.[88]

To ensure the adequacy and accuracy of information reported by exempt investment funds, it is also important to ensure the agency responsible for maintaining the BO register has the capacity to:

- record the fact that an exemption has been granted on the basis that the declaring entity is an investment fund with the adequate ownership disclosure requirements; and
- check and, if necessary, reject claims for exemptions based on the grounds provided.

Taking a comprehensive policy approach

Beyond these considerations, BOT should be viewed as one of multiple policy solutions to address the complex question of how to effectively regulate the investment industry. Given its mammoth size and high level of complexity, a comprehensive policy approach is needed to ensure transparency and accountability. Factors such as the involvement of large and growing quantities of cross-border capital flows; interests across a wide variety of actors; divergence in other relevant regulatory frameworks, such as those in place for AML and securities trading; and ever-changing systems of financial secrecy make it essential but challenging to holistically regulate the investment sector.

Examples of other important complementary measures to BOT include requiring that all investment professionals carry out AML practices in line with other financial institutions, such as CDD/KYC checks; ongoing risk assessments of national investment industries; and training for law enforcement on the complexities of private investment funds and the manner in which they can be used to hide illicit assets.[89] BO registers form an integral part of this approach because they enable BO data to be used to achieve a jurisdiction's policy aims by centralising the information and ensuring it is readily accessible. For example, data can be used by obliged entities as part of their CDD processes, and law enforcement as part of investigations. Effective implementation of BO reforms to account for the specific considerations of investment funds is an essential step towards effective data use for policy impact.

Endnotes

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