

Clients & Friends Memo

UK Proposal for Register of Foreign Beneficial Ownership of Real Estate Continues Global Trend Toward Transparency

20 April 2017

On 5 April 2017, the UK Department for Business, Energy & Industrial Strategy (the “Department”) issued a call for evidence (the “proposal”) for a public register (the “foreign ownership register”) which would contain information about the beneficial ownership of foreign companies or foreign entities that own or buy UK property, or that participate in certain UK central government procurement activities.¹ The proposal responds to recent pressure on the UK government to enhance the transparency of foreign property investment, and is the latest global effort to increase transparency and prevent legal entities being used to camouflage money laundering and other corrupt activities.

Overview of the Foreign Ownership Register Proposal

The purpose of the foreign ownership register is to reduce the availability of real property being used in the UK as a vehicle for money laundering and corrupt activities by off-shore companies.² It is estimated that at least £100 billion passes through the UK every year as a result of money laundering activities.³ The UK receives more foreign direct investment than any other European country, making it particularly vulnerable to cross-border money laundering activities and corruption, and the Department has stated that the proposal is “an important element of the UK government’s new anti-corruption strategy”.⁴

¹ See https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/606611/beneficial-ownership-register-call-evidence.pdf.

² For example, in January 2016, the National Crime Agency secured the conviction of a money launderer who used offshore companies to launder £12 million by using UK council properties to disguise the money.

³ See comments made by Robert Barrington, Executive Director of Transparency International UK before the Home Affairs House of Commons Select Committee’s inquiry into the effectiveness of the UK’s proceeds of crime measures: <https://www.publications.parliament.uk/pa/cm201617/cmselect/cmhaff/25/2506.htm#footnote-053>

⁴ See https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/606611/beneficial-ownership-register-call-evidence.pdf (p. 11).

The foreign ownership register is one of a number of recent developments in the UK aimed at enhancing transparency and reducing financial crime. Other recent developments include:

- adoption of the people with significant control (“PSC”) register which came into effect in April 2016 (discussed further below);
- conducting a public consultation between January and March 2017 in respect of law reform of corporate liability for economic crime;⁵ and
- the passage of the Crime Finances Bill through the UK Parliament which is likely to become law later this year. Once enacted, corporates, particularly in the finance and professional services sectors, will be subject to new money laundering and tax evasion offences.

This memo will be of interest to foreign legal entities that own or are considering investing in real property in the UK, foreign legal entities considering participating in UK central government procurement activities, professional advisers, and service providers for foreign legal entities including banks and financial institutions.

Foreign Ownership Register Follows in the Footsteps of the PSC Register

The proposal for a foreign ownership register adopts many elements of the PSC register which commenced on 6 April 2016.⁶ The PSC register was designed to identify and make public the interests of individuals who are the ultimate owners or controllers of a UK company, as well as deter those who shield their interests with a penalty regime for non-compliance. At the time, it was the first type of transparency register implemented by a G20 member state.

The PSC requirements oblige UK companies, Societates Europaeae, and limited liability partnerships to maintain a register of the people who own or control their company. The information contained on an entity’s PSC register must be filed with Companies House, upon which it will form part of the public record containing details of individuals or legal entities that have significant control over the entity.

A PSC is an individual who meets one more of the following conditions in relation to a company:

1. an individual who holds more than 25% shares in the company;
2. an individual with more than 25% of the voting rights of a company;

⁵ See <https://www.gov.uk/government/consultations/corporate-liability-for-economic-crime-call-for-evidence>.

⁶ The PSC register came into effect pursuant to the incremental implementation of the Small Business, Enterprise and Employment Act 2015.

3. an individual who holds the right to appoint or remove the majority of the board of directors of the company;⁷
4. an individual that has the right to exercise, or actually exercises significant influence or control over the company; or
5. where a trust or firm satisfies any of the above conditions if it were an individual, then any individual holding the right to exercise, or actually exercising significant influence or control over the activities of that trust or firm.

For some kinds of entities, certain modifications to the above conditions apply as follows:

1. where a legal entity does not have share capital, it should consider rights to a share of the capital or profits of the entity;
2. where a legal entity does not have general meetings at which voting rights can be exercised, legal entities should consider any other equivalent voting rights in respect of the company; and
3. where a legal entity does not have a board of directors, it should instead consider rights to appoint or remove a majority of the equivalent management component of that entity.

Proposed Foreign Ownership Register

At the International Anti-Corruption Summit in London in May 2016, the UK government announced its intention to introduce a law creating a foreign property ownership register. The announcement followed an initial government discussion paper on the topic which was issued in March 2016,⁸ along with the public comments received.⁹

On 5 April 2017, the Department issued a more detailed proposal for the foreign ownership register,¹⁰ describing its possible design and analysing the potential effects. Members of the public

⁷ Conditions (i) to (iii) might be met directly or indirectly, for example, through another company.

⁸ See https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/512333/bis-16-161-beneficial-ownership-transparency.pdf.

⁹ See https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/606411/beneficial-ownership-transparency-summary-responses.pdf.

¹⁰ See <https://www.gov.uk/government/consultations/property-ownership-and-public-contracting-by-overseas-companies-and-legal-entities-beneficial-ownership-register>.

have until 15 May 2017 to comment on one or more of the 28 questions the Department has posed.¹¹

Key Elements of the Foreign Ownership Register Proposal

Scope

The proposal envisages that the foreign ownership register requirements will apply to all foreign legal entities holding an interest in UK property or bidding on central government contracts. It also proposes that where a foreign entity holds a registered leasehold with an original term of more than 21 years, it will be deemed to own property for the purpose of the foreign ownership register.

Initially, in its 2016 consultation paper, the Department had considered that the register would apply only to companies limited by shares. It has since proposed expanding the scope of the register, as UK land registry records do not specify which kind of entity holds legal title to a registered property.

The foreign ownership register is intended to apply across the UK and complement the proposals currently being developed by the Scottish government to improve transparency behind land ownership in Scotland.¹² Both the UK and Scottish governments have indicated a willingness to ensure that no entity will be required to submit duplicative reporting under each proposed register.

Beneficial Owner

The proposal envisages that the definition of beneficial owner for the purpose of the foreign ownership register will mirror that of the PSC register, so that foreign entities with registered real property interests, or who participate in government procurement, must maintain a register containing the names of the beneficial owners of the entity and provide this information to Company House for inclusion on the public searchable record. The proposal considers that foreign entities will be required to update information on the register at least once every two years and that it will be an offence if an entity fails to comply with the updating requirement.

¹¹ Responses should be sent to transparencyandtrust@beis.gov.uk.

¹² The Scottish government commenced a consultation in this regard in September 2016 which will be used to inform the development of regulations by the Scottish Parliament in 2017. See <https://consult.scotland.gov.uk/land-reform-and-tenancy-unit/controlling-interests/>.

Protecting Individuals at Risk

Similar to the PSC register, under the proposed foreign ownership register, an individual listed as having significant control over a foreign entity may apply to have their personal identifying information suppressed from public view if the individual is at risk of violence or intimidation.

Registered Property Only

The foreign ownership register is envisaged to apply only to land that is registered – currently estimated to be approximately 83% of land in England and Wales.¹³ However, unregistered land which is transferred (sold, mortgaged or leased) will trigger land registration requirements, and the foreign ownership register will apply to a foreign entity that acquires the interest in the initially unregistered land.

Equivalent Regimes in Other Countries

The European Fourth Money Laundering Directive will require all companies and certain other types of legal entities which are incorporated in the EU to provide information about their beneficial owners to a central register by June 2017. In order to avoid double-reporting, the proposal envisages an exemption applying to entities which are incorporated in countries with equivalent disclosure requirements to the UK. Whether or not EU or other countries implement a foreign ownership register regime which is equivalent to that of the UK remains to be seen.

Procurement

Once the foreign ownership register requirements commence, foreign entities participating in new¹⁴ central government procurement contracts will be required to supply beneficial ownership information before the contract can be finalised.¹⁵ The government has set out three different ways that the foreign ownership register requirements may operate:

- first, the preferred supplier will be required to provide its beneficial ownership information as a condition of being awarded the contract;
- second, by excluding bids from entities which fail to provide beneficial ownership information; and/or

¹³ In the UK, land registration is administered through the HM Land Registry.

¹⁴ The foreign ownership register requirements are not envisaged to apply to contracts which have already been procured or where procurement procedures already have commenced.

¹⁵ In circumstances where a foreign entity already provides this information under an equivalent regime in the country of its incorporation, the proposal provides that it is likely the foreign entity will need only provide information about the equivalent register.

- third, treating those bids that do not include the required beneficial ownership information as being incomplete or non-compliant and rejecting them on this basis.

Foreign Entities Wishing to Sell Property in the UK and Banks and Lenders with Security over Foreign Owned Property

Foreign entities that already own property in the UK when the law comes into force will be given one year to comply with the foreign ownership register requirements. If a foreign entity fails to comply within the one-year period, a note will be placed on the foreign entity's property title indicating that it cannot deal with that property – i.e., sell, mortgage or lease until such time that it complies with the law. The note will be publically visible on the title search result. A transfer of a property owned by a foreign entity which does not meet the foreign ownership register requirements will be void.

To ensure that banks or other lenders who have their interest secured against a property owned by a foreign entity with a beneficial interest can still enforce its security if the foreign entity fails to meet the foreign ownership register requirements, the government intends to allow banks and lenders to repossess or dispose of the property in order to recover any debt owed. This will create a loophole, however, enabling foreign investors using the guise of a lender to realise the value of their asset without disclosing beneficial ownership information. In order to close the loophole, the government is proposing to allow repossession or disposal such property only by legitimate or accredited lenders. No further detail has yet been provided on how this will operate.

Other Offences

Under the proposal it will be a criminal offence for a person to knowingly or recklessly provide false or misleading statements for the purpose of the foreign ownership register. This offence will complement the Section 112 Companies Act 2006 criminal offence of knowingly or recklessly providing false or misleading information to the Companies House registrar.

Similar Efforts in the United States

The proposal for a foreign ownership register in the UK is consistent with similar efforts in the United States to make it more difficult to use shell companies to hide illegal activity.

Global Targeting Orders in High-End Real Estate Markets

Last year, in a continued effort to identify individuals attempting to hide the proceeds of criminal activity through the anonymous purchase of real estate, the U.S. Treasury Department's Financial Crimes Enforcement Network ("FinCEN") issued Geographic Targeting Orders ("GTOs") in New York City and Miami, which require certain title insurance companies to report the identity of natural

persons who make all-cash purchases of high-value residential real estate through shell companies. Under the Bank Secrecy Act (“BSA”), FinCEN is authorized to issue GTOs for up to 180 days upon a finding by the Secretary of the Treasury that additional requirements are necessary to prevent evasion of the BSA’s recordkeeping and reporting provisions. Since then, FinCEN not only renewed the GTOs but expanded them to additional real estate markets in Los Angeles, San Francisco, San Diego, and San Antonio, each with different monetary thresholds that trigger the reporting requirements. In each case, the information collected is reported to FinCEN and used to provide intelligence on potential assets held by persons of investigative interest. They are currently scheduled to lapse in August 2017.¹⁶

Customer Due Diligence Rules for New Bank Accounts

Along similar lines and in response to release of the “Panama Papers,” in 2016 FinCEN issued final rules requiring banks, broker-dealers, and other “covered financial institutions” under the BSA to identify the beneficial owners who own or control certain legal entity customers at the time a new account is opened. The new rules apply when an account is opened by a new or existing “legal entity customer” – including a corporation, limited liability company, or other legal entity formed in the U.S. or overseas – and require the covered financial institution to identify and verify the natural person (or persons) who own or control the legal entity customer. In addition, the new rules amended the anti-money laundering rules for covered financial institutions to include risk-based procedures for conducting ongoing customer due diligence. The rules, which had been under development for years, represented a further effort to combat money laundering, terrorist financing, and tax evasion.¹⁷

In each case, there was a trend toward greater transparency behind the use of legal entities in the hope that pulling back the curtain would make it more difficult to use such entities to engage in money laundering and other corrupt activities.

Conclusion

These efforts at greater transparency, both in the UK and the U.S., represent a continuing trend to pull back the curtain on the use of legal entities and make it increasingly more difficult to use them to engage in money laundering and other criminal activities. Real estate investment in the UK (and particularly in London) and the U.S. (particularly in New York) represents an important component

¹⁶ For related Client & Friends memos on these topics see: (1) <http://www.cadwalader.com/resources/clients-friends-memos/fincen-targets-high-value-real-estate-transactions-in-new-york-and-miami>; (2) <http://www.cadwalader.com/resources/clients-friends-memos/fincen-tightens-the-screws-on-money-launderers-with-additional-scrutiny-of-high-value-residential-real-estate-transactions>; (3) <https://www.fincen.gov/news/news-releases/fincen-renews-real-estate-geographic-targeting-orders-identify-high-end-cash>

¹⁷ See <http://www.cadwalader.com/resources/clients-friends-memos/fincen-issues-final-rules-for-customer-due-diligence-requirements>

of property portfolios of many foreign investors. Banks and other financial institutions in both countries are similarly sought after as safe havens for funds of wealthy individuals worldwide. Going forward, it will be more difficult to make such transactions anonymously through the use of legal entities. While these increased transparency efforts are unlikely to discourage legitimate investors, they nonetheless will create additional compliance hurdles in an increasingly complex regulatory landscape.

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