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இலங்கை மத்திய வங்கி
CENTRAL BANK OF SRI LANKA

இலாசு இல்ட்டி ஸீகலக
நிதியியல் உ_ளவறிதற் பிரிவு
FINANCIAL INTELLIGENCE UNIT

අංක 30, ජනාධිපති මාවත, කොළඹ 01, ශ්‍රී ලංකාව
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Guidelines-02/2019

Ref: 037/08/001/0036/019

September 02, 2019

To: Chief Executive Officer/ General Manager/ Proprietor

Dear Sir/Madam,

Guidelines for Designated Non-Finance Businesses on Identification of Beneficial Ownership, No. 02 of 2019

The above mentioned guidelines will come into force with immediate effect and shall be read together with the Financial Transactions Reporting Act, No. 6 of 2006 and the Designated Non-Finance Business (Customer Due Diligence) Rules, No. 1 of 2018.

Yours faithfully,


E H Mohottay

Actg. Director/ Financial Intelligence

Cc: Compliance Officers

Guidelines for Designated Non-Finance Businesses on Identification of Beneficial Ownership, No. 02 of 2019

Part I

Introduction

1. These Guidelines are issued pursuant to Section 15 (1) (j) of the Financial Transactions Reporting Act No, 6 of 2006 (hereinafter referred to as FTRA). The Financial Intelligence Unit (hereinafter referred to as FIU), acting within the powers vested with it under the FTRA, issued the Designated Non-Finance Business (Customer Due Diligence) Rules, No. 1 of 2018 (CDD Rules for DNFBs) by Gazette Extraordinary No. 2053/20, dated January 10, 2018, effective from the date of issue, applicable to institutions that engage in “non-finance business” (hereinafter referred to as DNFBs) as defined under Section 33 of the FTRA. Rules 10-13, 17-19 of the CDD Rules for DNFBs established, inter alia, provisions requiring DNFBs identified under the Rules to take appropriate measures to identify and verify the natural person(s) who are the ultimate “beneficial owners” of a customer that is a legal person or legal arrangement, as defined in Rule 43 of the CDD Rules for DNFBs.
2. The following businesses and professions are considered as DNFBs under the FTRA.
 - a) Casinos/gambling houses/conducting of a lottery, including a person who carries on such business through the internet.
 - b) Real estate agents, when they are involved in transactions for their clients in relation to the buying and selling of real estate.
 - c) Dealers in precious metals and dealers in precious and semi-precious stones.
 - d) Lawyers, notaries, other independent legal professionals/accountants.
 - e) Trusts or company service providers.
3. These Guidelines provide an aid for DNFBs to identify and verify the beneficial owner and apply the CDD Rules for DNFBs. These Guidelines are not intended to be exhaustive and do not impose legally binding practices on any DNFB, and do not constitute legal advice from the

FIU. Nothing in these Guidelines should be interpreted as releasing DNFBs from any of their obligations under the CDD Rules for DNFBs or the FTRA.

Part II

A) Who is a Beneficial Owner?

4. The “beneficial owner” is a natural person who ultimately owns or controls customer or the person on whose behalf a transaction is being conducted including the person who exercises ultimate effective control over a legal person or a legal arrangement.
5. DNFBs conduct transactions or establish business relationships with individual customers as well as with corporate customers. Transactions with corporate customers can be any transaction conducted with a natural person, a “legal person” or a “legal arrangement”. “Legal person” means “an entity other than a natural person that is able to establish a permanent customer relationship with a non- finance business or otherwise owns property and includes a company, a body corporate, a foundation, a partnership or an association” whereas “legal arrangement” means “an express trust¹, a fiduciary account or a nominee” (as defined in the CDD Rules for DNFBs).
6. It is a DNFB’s obligation to determine the natural person(s) who is/are the ultimate beneficial owner(s). The ultimate beneficial owner must be a natural person and cannot be a company, an organization or a legal arrangement. There may be more than one beneficial owner associated with a customer.
7. If the customer is a natural person, the person can be treated as the beneficial owner unless there are reasonable grounds to show that he is acting on behalf of another or if another person is the beneficial owner of the property of the customer. If the customer is acting on behalf of another person, the individual may not be the beneficial owner.

¹ In terms of Section 03 of the Trust Ordinance No. 07 Of 1917 as amended by Section 2 of the Trusts (Amendment) Act No. 6 of 2018 (“Trusts Amendment Act”), an ‘express trust’ is defined as a trust that is created by the author of the trust generally in the form of an instrument in writing with certainty indicating the intention of the trust, but does not include a constructive or a de facto trust, whether charitable or not.

B) Why is it important to identify the Beneficial Owner?

8. Corporate entities such as companies, trusts, foundations, partnerships, and other types of legal persons and arrangements conduct a wide variety of commercial and entrepreneurial activities. However, despite the essential and legitimate role that corporate entities play in the economy, under certain conditions, they have been misused for illicit purposes, including money laundering (ML)², bribery and corruption, insider dealings, tax fraud, terrorist financing (TF)³, and other unlawful activities. This is because, corporate entities provide an attractive avenue to disguise the ownership and hide the illicit origin for criminals who are trying to evade anti-money laundering (AML) and countering the financing of terrorism (CFT) measures.
9. Various studies conducted by Financial Action Task Force (FATF), World Bank, United Nations Office on Drugs and Crime (UNODC) have explored the misuse of corporate entities for illicit purposes, including for ML/TF. In general, the lack of adequate, accurate and timely beneficial ownership information facilitates ML/TF by disguising:
 - a) the identity of known or suspected criminals,
 - b) the true purpose of a transaction executed by a corporate entity, and/or
 - c) the source or use of funds associated with a corporate entity.

Part III

Establishing the Beneficial Owner

A) Person on whose behalf a transaction is being conducted

10. Another aspect of the definition of beneficial ownership is a person on whose behalf a transaction is conducted. This may be the individual who is an underlying client of the customer. An example is, if a DNFB knows that person 'A' is conducting an occasional

² "Money Laundering" (ML) means the offence of money laundering in terms of section 3 of the Prevention of Money Laundering Act, No 5 of 2006.

³ "Terrorist Financing" means an act constituting an offence under section 3 of the Convention on the Suppression of Terrorist Financing Act, No. 25 of 2005.

transaction on behalf of person ‘B’, and then person ‘A’ and person ‘B’ should be identified and verified along with any other beneficial owners that may be a party to the transaction.

11. Acting on behalf of the customer means when a person is authorized to carry out transactions or other activities on behalf of the customer. However, ‘Authority to act’ should not be confused with ‘Effective control’. There are instances where persons are acting on behalf of a customer may not necessarily be the beneficial owners of that customer.
12. DNFBs have to identify the natural persons that act on behalf of the customer and verify the identity of such persons⁴. The authority of such person to act on behalf of the customer also should be verified through documentary evidence including specimen signatures of the persons so authorized.

B) Elements of identifying the Beneficial Owners of Legal Persons

13. DNFBs should consider following three main elements in the process of identifying Beneficial Owners of a legal person:
 - a) Which natural person(s) owns or controls more than ten percent (10%) of the legal person’s equity? (Controlling Ownership)
 - b) Which natural person(s) has “effective control” of the legal person? (Effective Control)
 - c) On behalf of which natural person(s) the transaction is being conducted? (Person on whose behalf a transaction is being conducted)

i) Element I – Controlling Ownership

14. DNFBs are required to understand the ownership and control structure of their customers which are legal persons⁵. Controlling ownership interest is defined as “an interest acquired by providing more than ten *per cent* of the capital of a legal person”. Accordingly, under this element, DNFBs are required to identify shareholders of the legal person having more than 10% of shares as the beneficial owners of the legal person. The prescribed threshold for

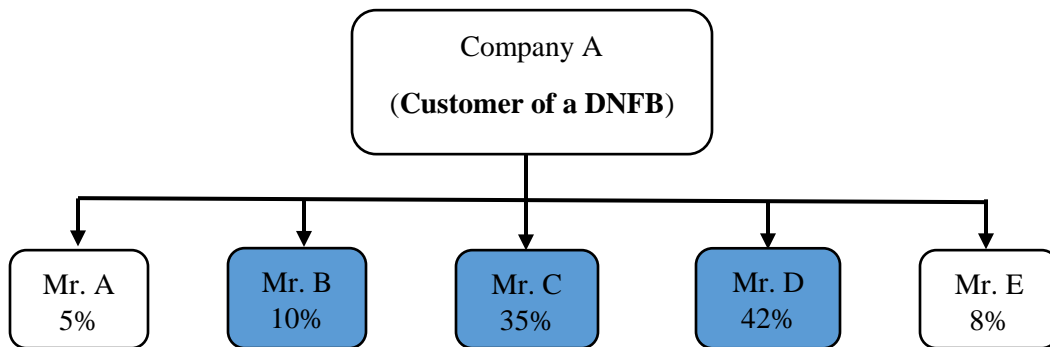
⁴ Please refer Rule No. 11 of the CDD Rules for DNFBs.

⁵ Please refer Rule No. 17 of the CDD Rules for DNFBs.

controlling interest is interpreted as owning more than ten percent (10%) of the customer that is a legal person ⁶. The ownership could be direct as well as indirect through aggregated ownership as illustrated below.

Figure 1: Direct Shareholding

‘Company A’ is a customer of a DNFB that is a legal person. Mr. A, Mr. B, Mr. C, Mr. D and Mr. E are direct shareholders of the ‘Company A’ whereas Mr. B, Mr. C and Mr. D are the beneficial owners having more than 10% of the ownership.

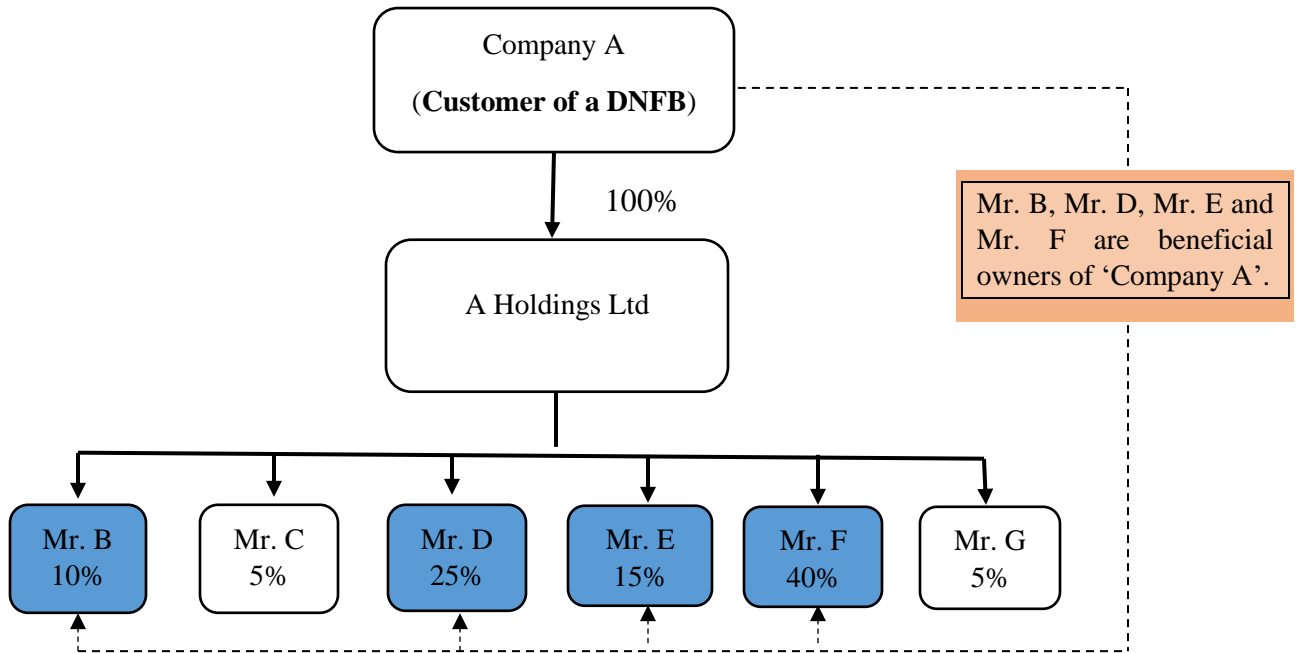


15. In addition, there can be indirect ownership structures as follows.

Figure 2: Indirect Shareholding

‘Company A’ is a customer of a DNFB that is a legal person. ‘A Holdings Ltd’ holds 100% of the shares of ‘Company A’ and Mr. B, Mr. C, Mr. D, Mr. E, Mr. F and Mr. G are the shareholders of the ‘A Holdings Ltd’.

⁶ Please refer Rule No. 18 (a) of the CDD Rules for DNFBs.



16. Some businesses maintain complex structures of ownership which would make it difficult to understand the ultimate beneficial owners.

Figure 3: Direct and Indirect Shareholding

'Company B' is a customer of a DNFB that is a legal person. 'Company C' holds 95% of the shares of 'Company B' and Mr. A holds the rest 5%. On the other hand, Mr. A holds the 100% of the shares of 'Company C'.

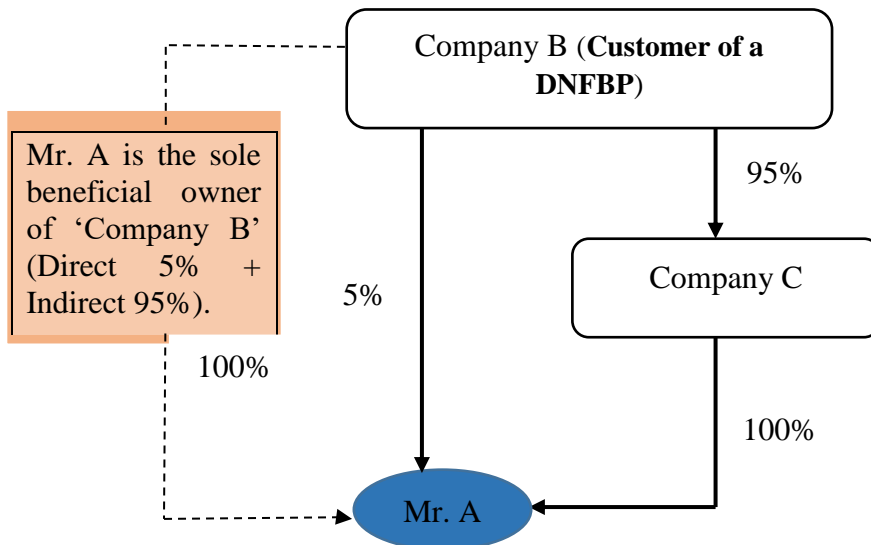
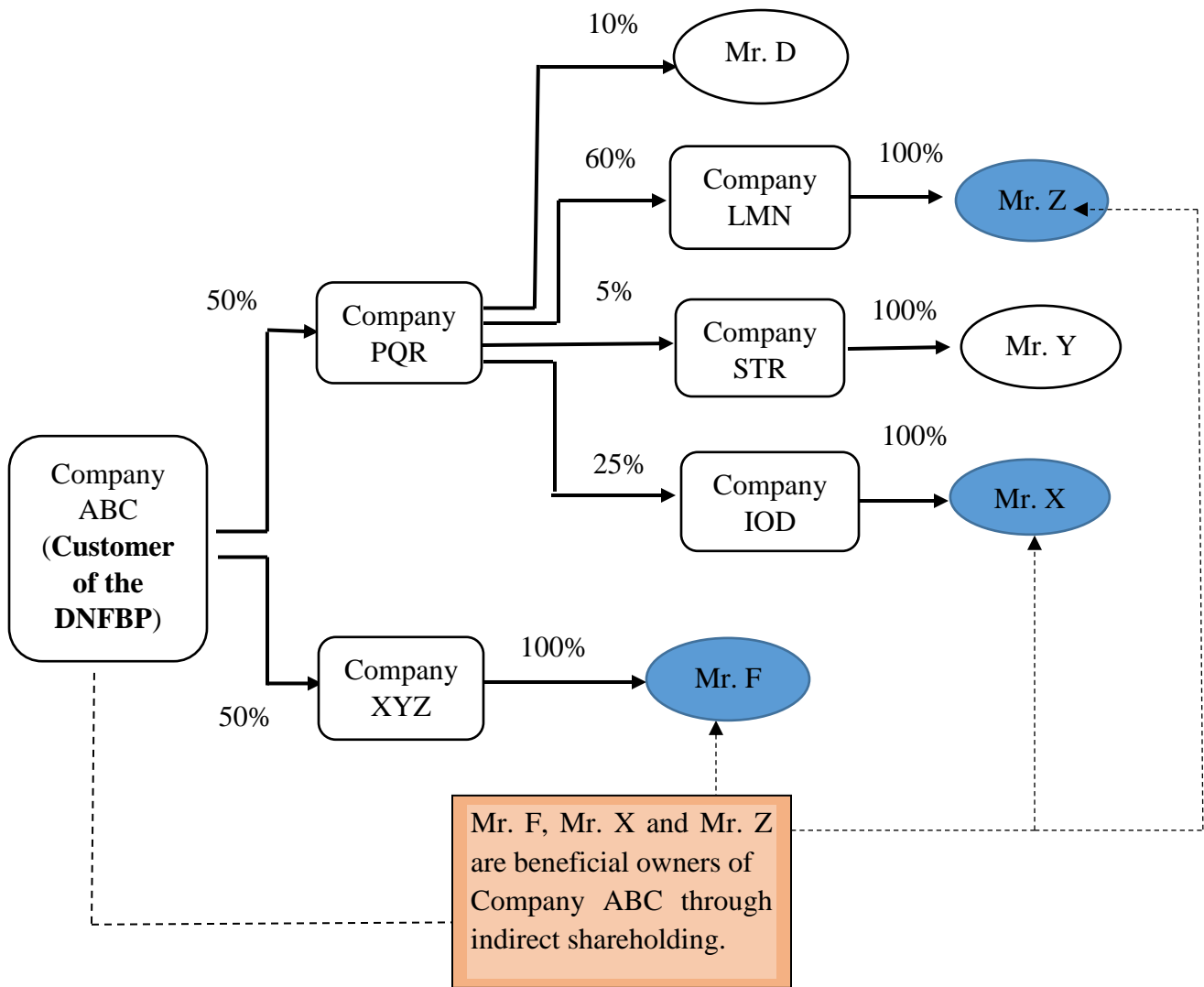


Figure 4: Multi-level indirect shareholdings

‘Company ABC’ is a customer of a DNFB that is a legal person. Both ‘Company PQR’ and ‘Company XYZ’ holds 50% of the shares of ‘Company ABC’. Shares of the ‘Company PQR’ are respectively held by Mr. D (10%), ‘Company LMN’ (60%), ‘Company STR’ (5%) and ‘Company IOD’ (25%). However, Mr. Z holds 100% of the shares of ‘Company LMN’, Mr. Y holds 100% of the shares of ‘Company STR’ and Mr. X holds 100% of the shares of ‘Company IOD’. Further, the 100% of the shares of ‘Company XYZ’ is held by Mr. F.



17. For some customers that are legal persons, ownership may be spread over a large number of individuals with all individuals owning less than ten percent (10%). In such instance, because

no individual(s) owns more than ten percent (10%), the effective control element outlined below would be more appropriate to determine the beneficial owner(s)/controller(s).

ii) Element II: Effective Control

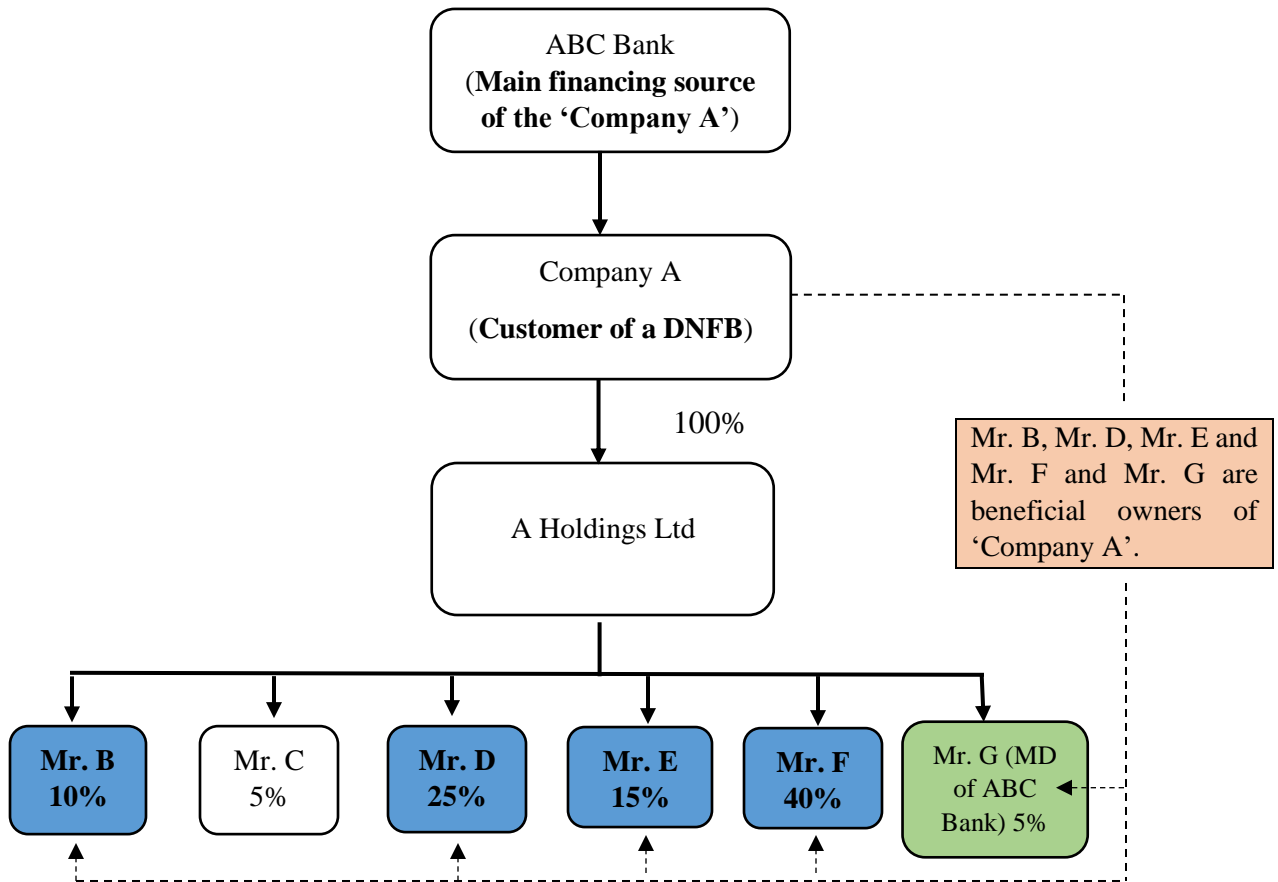
18. Effective control of a legal person is another important component that determines the beneficial ownership. Such control can be direct or indirect, formal or informal. At a direct and formal level, it is essential to understand a legal person's governance structure to identify the natural persons that exercise effective control over the legal person. In deciding the effective controller(s) in relation to a customer that is a legal person, DNFBs should consider,

- a) a natural person who can hire or terminate a member of senior level management;
- b) a natural person who can appoint or dismiss Directors;
- c) Senior managers who have control over daily/regular operations of the legal person/arrangement (e.g. a CEO, CFO or a Managing Director).

19. Natural persons may also control the legal person through other means such as:

- a) Personal connections to persons in positions such as an Executive Director/CEO/Managing Director or that possess ownership;
- b) Significant authority over a legal person's financial relationships (including with financial institutions that hold accounts on behalf of a legal person) and the ongoing financial affairs of the legal person;
- c) Control without ownership by participating in the financing of the enterprise, or because of close family relationships, historical or contractual associations;
- d) Use, enjoyment or benefiting from the assets owned by the legal person even if control is never exercised.

Figure 5: Effective Control



Mr. G is the Managing Director of the 'ABC Bank', which is the main financing source of the 'Company A' (the customer of DNFB that is a legal person). In such a situation even if Mr. G holds less than ten percent (10%) of 'Company A', he has effective control over the 'Company A' through ABC Bank and should be considered as a beneficial owner through effective control.

20. Where no natural person is identified under (13-17) above, DNFBs should identify and take reasonable measures to verify the identity of the relevant natural person who holds the position of senior managing officials.

C) Identifying Beneficial Owner of Legal Arrangements

21. All trusts have the common characteristic of causing a separation between legal ownership and beneficial ownership. Legal ownership always rests with the trustee. Beneficial ownership can rest with the author of trust, trustees or beneficiaries, jointly or individually.
22. The DNFBs should identify and take reasonable measures to verify information about a trust, including, the identities of the author of the trust, the trustees, the beneficiary or class of beneficiaries, and protector, where applicable, and any other natural person exercising ultimate effective control over the trust (including those who control through the chain of control or ownership)⁷.
23. DNFBs are required to obtain trust documents (e.g. deed of trust, instrument of trust, trust declaration, etc.) and the provisions of the trust document must be fully understood within the context of the laws of the governing jurisdiction. The DNFBs should take reasonable measures to verify trust document through independent means (e.g. Registry of Trust, Notary).

Part IV

Ways in which Beneficial Ownership information can be hidden

24. Beneficial ownership information can be concealed through various ways, including but not limited to;
 - a) use of shell companies⁸ (which can be established with various forms of ownership structures). Especially if the shell companies are involved in foreign ownerships, the impact will spread across jurisdictions,
 - b) complex ownership and control structures involve many layers of ownership. Sometimes, it can be in the name of another legal person and sometimes it may use a chain of ownership that is spread across several jurisdictions,

⁷ Please refer Rule No. 19 of the CDD Rules for DNFBs.

⁸ Shell companies are companies that are incorporated with no significant operations or related assets, including an absence of physical presence.

- c) purchase of properties under the names of third parties where no relationship can be found,
- d) use of legal persons as directors,
- e) formal nominee shareholders⁹ and directors where the identity of the person who nominates such shareholders or directors is hidden,
- f) informal nominee shareholders and directors, such as close associates and family,
- g) trust and other legal arrangements, which enable a separation of legal ownership and beneficial ownership of assets, and
- h) use of intermediaries in forming legal persons, including professional intermediaries such as accountants, lawyers, notaries, trust and company service providers.

Case Study on Identifying Beneficial Owners of a Legal Person

ABC Company Ltd is a private limited liability company registered under the Companies Act, No. 7 of 2007. ABC Company Ltd comes to a Real Estate Agent to buy a land plot.

Mr. A owns 30% of the shares of ABC Company Ltd and XYZ Company Ltd holds the balance 70% of shares of ABC Company. Further, Mr. S is the Managing Director of ABC Company and the Board of Directors are his wife, Mrs. S and their three children.

In this example the Real Estate Agent is required to identify the following in relation to ABC Company Ltd as required by Rule 17 of the CDD Rules for DNFBs:

1. Understand the nature of the customer's business, its ownership and control structure.
 - the ownership of the ABC Company Ltd - shared by Mr. A (30% of the shares) and XYZ Company Ltd (70% of the shares);
 - the ownership structure of the entity - ABC Company Ltd is a business owned by family members and traded privately;

⁹ A nominee shareholder refers to a company member holding the shares on behalf of the actual owner or beneficial owner. He/she is the registered owner of the share. A nominee shareholder holds the share under a custodial agreement.

2. Identify the customer and verify its identity as required by Rule 17 (b) of the CDD Rules for DNFBs.
 - the identification of all members of the Board of Directors (Mr. S's Family) as they are having effective control;
3. Identify and verify the identity of beneficial owners as required by Rule 18 of the CDD Rules for DNFBs.
 - identification and verification of identity of Mr. A as he is having more than 10% of ownership;
 - identification of all of the individuals who own or control, directly or indirectly, 10% or more of the shares of XYZ Company Ltd since it owns 70% of the shares, it also exercises control;
 - however, in a case like this, Real Estate Agent must research further to determine whether any individual owns enough shares of XYZ Company Ltd that would constitute 10% of ABC Company Ltd, or until Real Estate Agent determines that there is no such individual;
 - the manner in which DNFBs obtained this information; and
 - the measures taken to verify accuracy of information.

Part V

What should you do to Identify and Verify Beneficial Ownership Information?

25. DNFBs identify and take reasonable measures to verify the identity of the beneficial owner(s) of the customers that are legal persons and legal arrangements.
26. Accordingly, the identification of beneficial owner is mandatory. Once the DNFBs establishes who the beneficial owner(s) of a customer is/are, the DNFBs must collect at least the following information in relation to each individual beneficial owner,
 - a) the full name;
 - b) permanent residential or mailing address;

- c) occupation, name of employer, business or principal activity;
 - d) an official personal identification number or any other identification document that bears a photograph of the customer or beneficial owner such as the National Identity Card, passport or driving license;
 - e) date of birth;
 - f) nationality;
 - g) source of funds;
 - h) purpose of transaction;
 - i) telephone numbers (residence, office or mobile).
27. DNFBs are also required to take reasonable measures to verify the identity of the beneficial owner before or during the course of entering into a business relationship with, or conducting a transaction for an occasional customer¹⁰ by requiring the customer to furnish the original document and making a copy of the said document.
28. The reasonable measures for verification should be taken subject to the risk and complexities of the ownership and control structure of the legal person or arrangement.

Part VI

A) Beneficial owners who are Politically Exposed Persons (PEPs)

29. DNFBs are required to implement appropriate internal policies, procedures and controls to determine if the beneficial owner is a Politically Exposed Person¹¹. Through such processes, if the DNFB identifies any beneficial owner as a PEP, the relationship should be subject to enhanced due diligence as required in the CDD Rules for DNFBs.

¹⁰ Please refer Rule No. 13 of the CDD Rules for DNFBs.

¹¹ Please refer Rule No. 24 of the CDD Rules for DNFBs.

B) Record keeping obligations

30. The DNFBs are required to maintain records of identification and verification information relating to beneficial ownership as prescribed under CDD Rules for DNFBs¹² and FTRA.

C) Reporting Obligations

31. When a DNFB is unable to comply with CDD measures as required in CDD Rules for DNFBs including identification and verification of beneficial ownership information, and/or CDD measures would tip off the customer, it shall immediately file a Suspicious Transaction Report in compliance with Section 7 of the FTRA¹³.

D) Sanctions

32. Failure to comply with the beneficial ownership requirements as required under the CDD Rules for DNFBs will be a violation of Section 2 (3) of the FTRA and will be punishable under Section 19 of the FTRA.

¹² Please refer Rule No. 38(1) of the CDD Rules for DNFBs.

¹³ Please refer Rule No. 14 of the CDD Rules for DNFBs.