BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

AML/CFT Thematic Report

Implementation of Beneficial Ownership (BO) Requirements by Legal Sector

Prepared by: Financial Intelligence and Enforcement Department (FIED)

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Table of Contents

Pg 1 **Objective**

Pg 1 **Scope**

Part A : Overview & Overall Assessment

Pg 2 Overview

Pg 3 Overview of Regulatory Requirements on BO

Pg 4 Overall Assessment

Part B : Supervisory Findings

Pg 5 i. CDD on Legal Person Clients

Pg 8 ii. Provision of Nominee Service by Lawyers

Pg 9 iii. Reliance on Third Parties

Pg 11 iv. Ongoing Due Diligence

Part C : Way Forward

Pg 12 Ensure Compliance with AML/CFT Requirements

Pg 14 **Part D: References**



Objective

This thematic supervisory review on the implementation of the BO requirements is conducted, with a view to:

- Understand the existing practices in the identification and verification of BOs of legal person or legal arrangements client by law firms;
- Understand the law firms' existing arrangements when dealing with the banking institutions, particularly in relation to transactions facilitated through the client accounts; and
- Identify the common gaps or challenges faced by the reporting institutions (RIs) in meeting the BO requirements and related issues.

The findings of this thematic review are aimed to:

- inform on gaps or challenges faced by the RIs; and
- suggest for industry best practices to better improve the implementation of BO requirements.

RIs are advised to refer to the findings and recommendations in this report and to perform self-assessment to help identify gaps and areas of improvements in complying with the BO requirements.

Scope

The data and observations presented in this report were obtained from various sources:

- RIs' self assessment results obtained from Data and Compliance Report 2021 (DCR 2021);
- Written responses obtained from questionnaire issued to selected law firms; and
- Supervisory observations from on-site or off-premise examinations conducted on selected law firms.

This report consists of 4 parts:

Part A : Overview & Overall Assessment

Part B : Supervisory Findings:

i. CDD on legal person clients
ii. Provision of nominee services by lawyers
iii. Reliance on third party
iv. Ongoing Due-Diligence

Part C : Way Forward

Part D : References

Part A:
Overview & Overall Assessment

Overview

Corporate vehicles are an attractive way to disguise and convert the proceeds of crime before channelling them into the financial system. They can be misused to circumvent anti-money laundering and countering financing of terrorism (AML/CFT) controls by disguising the identity of known or suspected criminals and the source of funds or assets.

According to the National Risk Assessment 2020 (NRA 2020), investigations have unravelled more complex laundering methods used by criminals in recent years. These include the use of complex legal corporate structures and charitable foundations beneficially owned or controlled through an associate or family member of the perpetrator. Further, lawyers that offer nominee shareholder or directorship services, and to a certain extent trustee services, are also at high risk to be abused for money laundering as those services can enable concealment of BO.

In mitigating ML/TF risks, the Financial Action Task Force (FATF) has established international standards that address the transparency and BO of legal persons and legal arrangements to prevent the misuse of legal persons and legal arrangements for criminal purposes.

Particularly, the FATF Recommendations 10 and 22 require financial institutions and designated non-financial businesses and professions (DNFBPs), including lawyers, to undertake customer due diligence (CDD) measures which include identification of BOs as well as taking reasonable measures to verify the identity of the BOs. Whilst, Recommendations 24 and 25 provide further requirements for countries to provide transparency for legal persons and legal arrangements.

In line with the international standards set by the FATF, RIs are required to identify and take reasonable measures to verify the identity of BOs of legal person or legal arrangements clients when establishing business relations with such clients, as encapsulated under the Anti-Money Laundering, Anti-Terrorism Financing and Proceeds of Unlawful Activities Act 2001 (AMLA) and the AML/CFT and Targeted Financial Sanctions for Designated Non-Financial Businesses and Professions (DNFBPs) and Non-Bank Financial Institutions (NBFIs) (AML/CFT and TFS for DNFBPs and NBFIs) Policy Document (hereafter referred to as 'Policy Document').

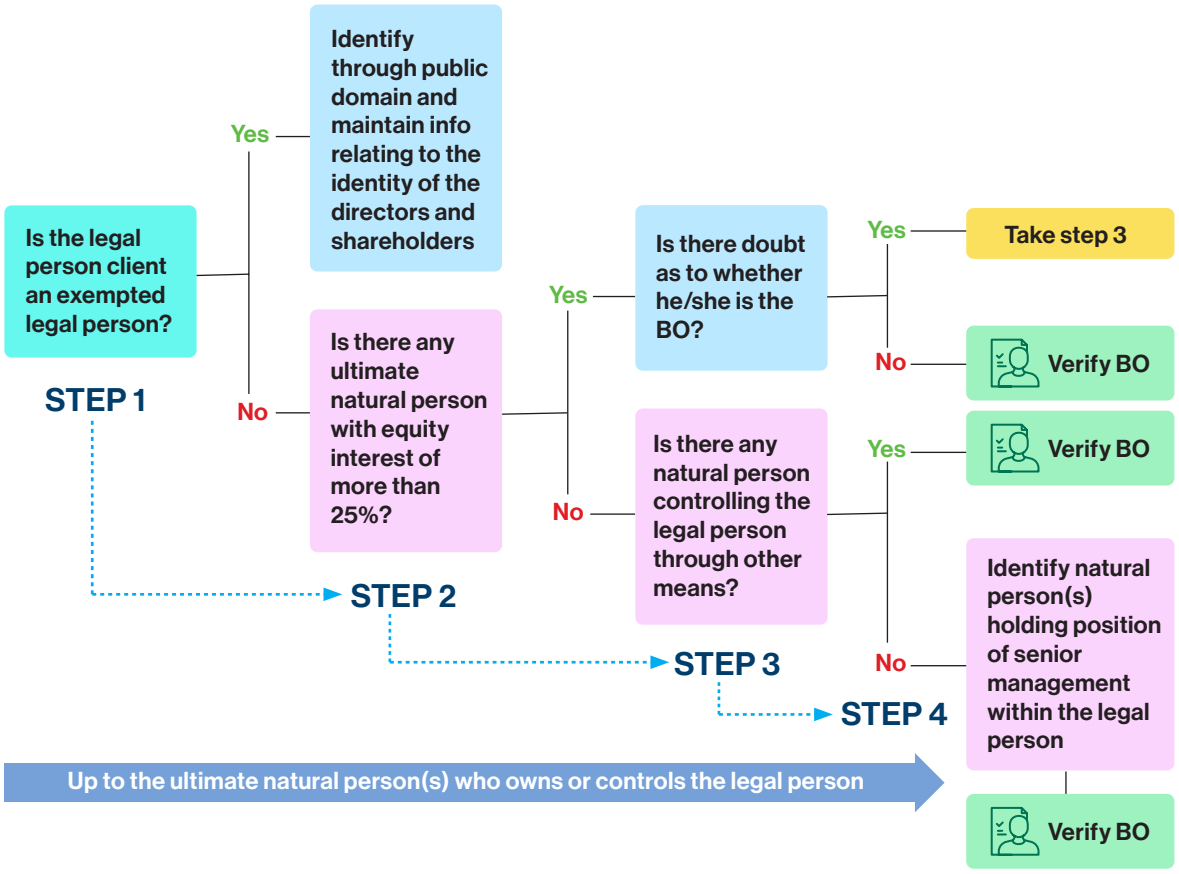
Overview of Regulatory Requirements on BO

Section 16(2) of the AMLA provides that RIs are required to undertake CDD measures when they carry out the specified activities for or on behalf of their clients.

Under paragraph 14.10.6* of the AML/CFT and TFS for DNFBPs and NBFIs Policy Document, all RIs, including the law firms, are required to **identify and take reasonable measures to verify the identity of BO according to the following sequence:**

- Natural person(s) who ultimately has a controlling ownership interest in a legal person with equity interest of more than 25%;
- If none or there is doubt as to whether the person(s) is the BO(s), natural person who exercises control through other means; and
- If none of the above, natural person who holds the position of Senior Management.

In respect of trusts, the settlor, the trustee(s), the protector (if any), the **beneficiary or class of beneficiaries,** and any other natural person **exercising ultimate effective control** over the trust; or equivalent or similar positions for other types of legal arrangements.



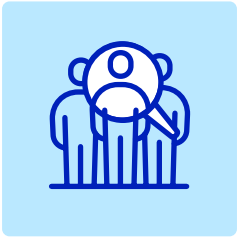
* Section 16(5) further provides for Bank Negara Malaysia (BNM) as the competent authority to issue necessary directions or guidelines to RIs on the undertaking of CDD measures, which has been stipulated in the Policy Document.

Overall Assessment

CDD on Legal Person Client & Third-Party Reliance

- Based on the data , majority of the law firms are in compliant with the basic CDD requirements on legal person clients, but lapses were commonly observed mainly on identification of BO particularly on unwrapping of multi-layer shareholding and undertaking the cascading steps in identification of BO.
- From the sample, some law firms adopt more stringent threshold of equity interest (e.g. 20% of shareholding or all shareholders) in identification of BO.
- Lapses were also commonly observed on reliance of third parties for CDD on clients referred by other law firms (especially foreign law firms) where there is no proper arrangement established as required by the Policy Document before relying on third parties for CDD.

Provision of Nominee Services



- Some law firms provide nominee services for their clients, mainly as nominee director, to fulfil local resident director requirement. Noting that nominee relationship has been classified as high-risk services, in effect, enhanced CDD shall automatically be applied to sufficiently mitigate this high-risk relationship as provided under the Policy Document.
- Common gap observed where law firms did not conduct enhanced CDD on clients when providing such services for their clients as per the requirement in the Policy Document.



Conduct of Ongoing Due Diligence (ODD)

- Majority of the law firms are in compliant with the ODD requirements with no issue in updating of CDD information, as fresh CDD information will normally be requested for a new deal or transaction.
- Lapses were commonly observed on transaction monitoring in ensuring the transactions being conducted are consistent with the profile of the clients.

Part B: Supervisory Findings

i. CDD on Legal Person Clients

Context: Exposures of Legal Sector to Legal Person Clients

73%
of law firms have legal person clients

11%
of law firms have legal arrangement clients

Clients by Type of Entities



* Percentage of law firms with exposure to clients of such entity type

Implementation of Cascading Steps in Identification of BO



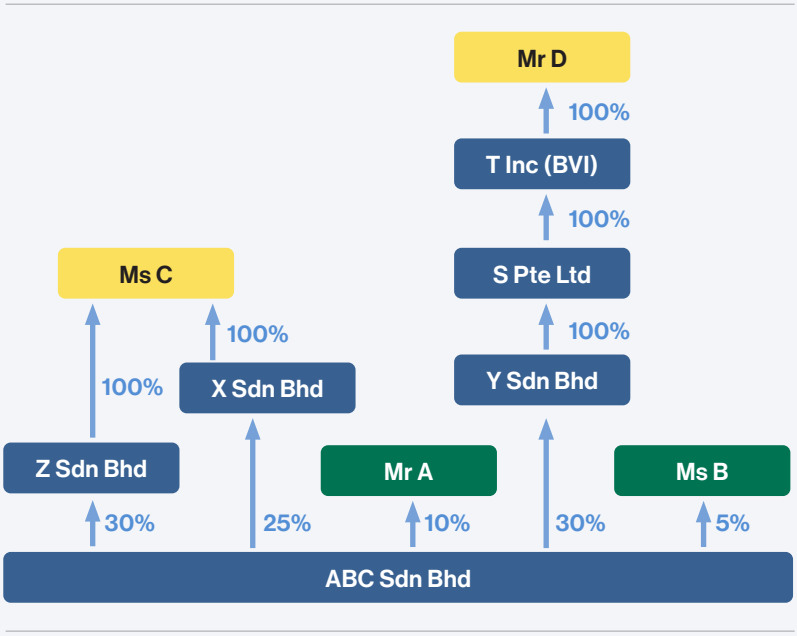
Majority of the law firms are in compliant with the basic CDD requirements on legal person clients but lapses were commonly observed mainly on identification of BO particularly on **unwrapping of multi-layer shareholding and undertaking the cascading steps in identification of BO.**

Common gaps on implementation of BO related requirements observed are as follows:

- Unaware or limited understanding of the BO requirements
- Identify BO only for higher risk clients
- Identify majority shareholder as BO only (i.e. above 50% of shareholding)
- Did not consider control beyond ownership interest
- Fail to unwrap multi-layer shareholding
- Fail to consider indirect and aggregated ownership interest
- Fail to undertake the cascading steps in identification of BO (e.g. identify senior management as BO directly)
- Verification fully based on self-declaration by client
- Did not obtain full CDD data points of BO as required by the Policy Document especially for BO of foreign entity

Case Study: Legal Person Client with Multiple Layers of Ownership

- Legal firm X is acting on behalf of a domestic company, ABC Sdn Bhd, newly established for a sale and purchase of property transaction.
- Legal firm X conducts CDD on the client (i.e. ABC Sdn Bhd) and found that it is owned by Mr A, Ms B, X Sdn Bhd, Y Sdn Bhd and Z Sdn Bhd. However, legal firm X failed to identify and take reasonable measures to verify all layers of ownership until the ultimate BOs (i.e. Mr D and Ms C).
- It was discovered that ABC Sdn Bhd has complex legal structure with multiple layer of shareholding including foreign company at offshore centre. Further, legal firm X also could not explain the rationale of the complex legal structure of ABC Sdn Bhd.



Good Practice: Conduct of CDD on BOs of clients

- Adopt more stringent threshold of ownership interest in determining BO
- Obtain relevant documents for clear understanding of ownership or control structure of corporate client (e.g. corporate ownership chart and management structure)
- Develop internal CDD form containing series of questions or steps in identifying BO
- Enquire on any arrangements or agreements indicating actual control beyond ownership
- Monitor all parties' relationships throughout the course of business relationship (e.g. person actively giving instructions, family members, employer-employee relationship, etc)
- Request for declaration from client after taking all reasonable measures in determining BO, where necessary, statutory declaration
- Verify through independent documents provided by the client, public registries or government authorities
- Conduct public search to corroborate with information provided by the client
- Request for relevant documents for verification (e.g. corporate documents, nominee, trust, shareholder agreements)
- Have face-to-face meeting with the shareholders/directors
- Engage independent data service provider for verification

Identification of BO: Nominees Acting on Behalf of Clients

Clients may nominate nominees to act on their behalf for a transaction. According to NRA 2020, ML/TF risks arise when there is use of nominees to disguise ownership in property for real estate properties transactions or use of nominee in fronting the transaction, including placement of illicit proceeds into client accounts for property purchase, coupled with subsequent rapid buying and selling of the property to realise the illicit proceeds.



50%
of law firms indicated that they are able to identify nominees acting on behalf of clients

Common methods used to identify BO behind nominee

- ☑ Require client to make declaration in KYC form
- ☑ Monitor throughout the course of dealing with client (e.g. chain of instruction, parties' relationship, etc.)
- ☑ Conduct public search to corroborate with information provided by client

Common documents used to identify or verify BO behind nominee

Trust Deed | **Nominee Agreement** | **Power of Attorney** | **Other form of authorization**

Challenges Faced

Identification of BO involving nominee arrangement especially for those informal nominee arrangement without any documentation

ii. Provision of Nominee Service by Lawyers

Background

There are legitimate reasons for the use of nominee service, particularly to fulfil other regulatory requirements. However, criminals may abuse it to hide the true identity of the BO.

Lawyers should perform their AML/CFT obligations when providing nominee services to the clients. They should understand the reason for the request and ensure that they are able to verify the identity of the BO and that the purpose is legitimate.

This is important to prevent the unlawful use of legal persons and arrangements, by gaining a sufficient understanding of the client to be able to properly assess and mitigate the potential ML/TF risks associated with the business relationship.

As provided under paragraph 14C of the Policy Document, lawyers are also required to conduct enhanced CDD when nominee services are provided.

Malaysia's Context



15%
of the law firms responded that they provide nominee services for their clients.

- The common reason observed for requesting for nominee service is to fulfill the local resident director requirement under the Companies Act 2016.
- It is observed that the lawyers who act as nominee director will not be involved in any business operation of the company such as executing contracts or agreements, statutory declaration of audited financial statements, acting as the cheque or account signatories, attending board meeting, any decision-making purposes, etc.
- There was **absence of enhanced CDD** conducted by lawyers when providing nominee services.

iii. Reliance on Third Parties

Background

RIs may rely on third parties to conduct CDD or to introduce business. Third parties refer to RIs that are supervised by a relevant competent authority for AML/CFT purpose and meet necessary requirements under reliance on third parties. For Malaysia, these RIs include banking institutions, insurance companies, money services business, lawyers, accountants, company secretaries, etc.

In the context of legal sector, law firms may be the RI relying on third parties (when acting as joint counsel) or as the third parties being relied upon (when dealing with banking institution in the conduct of client account).

(i) Conduct of CDD when Acting as Joint Counsel

There may be situations where more than one law firm or lawyer prepares for or carries out a transaction, or acting as joint counsel for a transaction introduced by another law firm including foreign law firm.

RIs may rely on third parties to conduct CDD in accordance with paragraph 16 of the Policy Document. However, RIs shall not rely on third parties to conduct ODD (including transaction monitoring).

Good Practices

- ✓ Conduct independent CDD despite the CDD conducted by lead counsel
- ✓ Establish proper arrangement with the lead counsel on reliance of CDD conducted by lead counsel upon satisfying that the lead counsel:
  - has in place adequate CDD process and record keeping requirements;
  - able to provide CDD information and relevant documentation immediately upon request; and
  - is properly regulated and subjected to AML/CFT supervision by relevant supervisory authority.

Gaps Observed for Conduct of CDD when Acting as Joint Counsel

- ✗ Absence of necessary assessment on the third party relied upon on its CDD process
- ✗ Place reliance on third party without proper arrangement that clearly specifies the rights, responsibilities and expectations of all parties
- ✗ Fully discharge its responsibility and accountability for CDD measures to third party which leads to not understanding of client's profile and risk as well as inability to perform necessary transaction scrutinization

Actions Required

- **The relationship** between RI and the third parties relied upon by the RI to conduct CDD **shall be governed by an arrangement** that clearly specifies the rights, responsibilities and expectations of all parties. Please refer to paragraph 16.5 (a) and (b) of the Policy Document for minimum expectation for placing reliance on third party.
- RI **shall obtain an attestation** from the third party to satisfy that the requirements on third parties reliance have been met. The attestation can be in any form that is mutually agreed by both parties.
- The ultimate responsibility and accountability for CDD measures shall always remain with the RI relying on third parties and shall not rely on third parties to conduct on-going due diligence of its clients.

Note: The requirements regarding reliance on third parties are consistently applicable to all RIs (both financial and DNFBP sectors) under the AMLA.

(ii) Conduct of CDD for Client Accounts

Lawyers need to open client accounts when they receive money on account of person(s) that the lawyers are acting for. This includes solicitor trust money, disbursement and monies payable to third parties by the clients.

When the law firms open client accounts with the banking institutions, banking institutions may rely on the law firms when they are unable to conduct CDD on the clients of the law firms.

Good Practices

✓ Put in place proper arrangement that clearly specifies the rights, responsibilities and expectations of the law firms and the banking institution on the conduct of CDD on beneficiaries of funds in the client accounts

Gaps Observed for Client Accounts

✗ Failure to provide attestation on conduct of CDD as per the Policy Document

✗ Failure to perform its CDD responsibility on certain transactions that pass-through the client accounts particularly for those transactions that were conducted for or on behalf of their clients (e.g. third party payment)

✗ Failure to cooperate with the other counter party RIs for provision of CDD information and documents, and for transaction monitoring

Providing CDD Information and Copies of Relevant Documentation to Banking Institutions

Pursuant to the Policy Document, banking institutions may rely on a third party when they are unable to conduct CDD on the clients of professionals where the identification of beneficiaries of a beneficiary account on an individual basis cannot be performed.

In the case of client accounts, the banking institutions may rely on law firms to conduct CDD for transactions that pass-through the client accounts provided that paragraph 16 of the Policy Document is fulfilled which includes that the third party relied upon is able to provide the CDD information and copies of the relevant documentation immediately upon request.

Where a banking institution is unable to comply with the CDD requirements, it shall not open the account, commence business relations or perform any transaction, or shall terminate business relations in the case of an existing customer.

iv. Ongoing Due Diligence

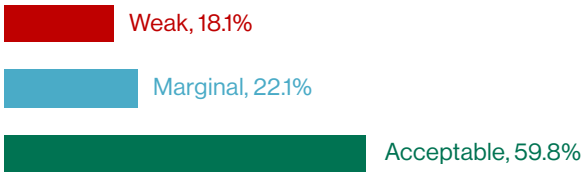
Background

Lawyers are required to conduct on-going monitoring of the business relationship on a risk related basis, to ensure that they are aware of any changes in the client's CDD information and risk profile established at client acceptance. This includes:

i. Updating CDD information collected to ensure it is kept up-to-date and relevant; and

ii. Appropriate level of scrutiny of activity during the relationship, including enquiry into source of funds where necessary, to judge consistency with expected behaviour based on accumulated CDD information.

Implementation of Ongoing Due Diligence



Based on DCR 2021, majority of the law firms are in compliant with the ODD requirements of which generally majority of them do not have issue with updating of CDD information but **lapses were commonly observed on transaction monitoring.**

Good Practices

- ✓ Good understanding of the background of the parties involved and transaction conducted
- ✓ Monitor the mode of payment as well as party making payment to mitigate any ML/TF risks

Common Gaps

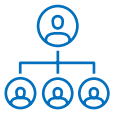
- ✗ Only act on client's instruction without monitoring of ML/TF risks
- ✗ Monitor incoming and outgoing payments merely to ensure fulfilment of contractual terms



Part C: Way Forward

Ensure compliance with AML/CFT requirements

Make use of the results of the observations in this report and self-assessments of your DCR submission and rectify gaps identified. Particularly,



CDD on Legal Person Client & Third-Party Reliance

(i) CDD on legal clients and their BOs

- RIs are required to ensure effective implementation of CDD on their clients, including the BO. Specifically, RIs need to **undertake the cascading steps** in identification and verification of BO of legal person clients which shall include **aggregate direct or indirect equity interest as well as control through other means.**

(ii) Identification of BO for nominee arrangements

- When nominees acting for legal person clients, identification of BO can be done via:
  - For formal arrangement - obtain power of attorney or other documentation
  - For informal arrangement - can be conducted through self-declaration, collaboration with other sources (e.g. annual return submitted to SSM) or other circumstantial evidence (e.g. instruction from third party, other unusual behaviour), etc.

(iii) Third-Party Reliance

- **The relationship** between RI and the third parties relied upon by the RI to conduct CDD **shall be governed by an arrangement** that clearly specifies the rights, responsibilities and expectations of all parties. Please refer to paragraph 16.5 (a) and (b) of the Policy Document for minimum expectation for placing reliance on third party.
- RIs **shall obtain an attestation** from the third party to satisfy that the requirements on third parties reliance have been met. The attestation can be in any form that is mutually agreed by both parties.
- The ultimate responsibility and accountability for CDD measures shall always remain with the RI relying on third parties and shall not rely on third parties to conduct on-going due diligence of its clients.

Note: The requirements regarding reliance on third parties is consistently applicable to all RIs (both financial and DNFBP sectors) under the AMLA.

Particularly for BO requirements, RIs may also refer to the Guidance on Beneficial Ownership for better understanding and practical implementation guide.



Provision of Nominee Service

RIs need to conduct enhanced CDD when providing nominee services for their clients, including:

- Obtain CDD **and additional information** on the client and BO;
- Enquire on **source of wealth or source of funds;** and
- Obtain **Senior Management's** (in the case of law firms, can be partner or senior partner) **approval** before starting business relationship with client.



Ongoing Due Diligence

- RIs need to ensure clients' information is up-to-date and monitor the transactions undertaken by clients to ensure that they are consistent with the risk and profile of the clients including mode of payment, origin of fund, etc.



Appoint and Notify Compliance Officer (CO)

All RIs must ensure COs are appointed as the person who will be responsible in AML/CFT implementation within the firms and notify BNM of the appointment through this link: **Compliance Officer Nomination Notification Form.**



ENFORCEMENT ACTION IS BEING PURSUED ON RI(S) MORE VIGOROUSLY BEGINNING 2022

RIs must ensure compliance with the AML/CFT requirements as well as implement remedial measures to address gaps identified either from DCR or thematic review.

If selected for onsite examination and it is found that major gaps are still persistent, enforcement action can be instituted on the firms.

Part D: References

1. AML/CFT Laws, Regulations and Guidances

A. AMLA
B. AML/CFT and TFS for DNFBPs and NBFIs Policy Document - English version
C. AML/CFT and TFS for DNFBPs and NBFIs Policy Document - Bahasa version
D. Circulars/ Guidances/ FAQs issued by BNM including:
   i. Guidance on Beneficial Ownership
   ii. Reference Note for Company Secretaries on Requirements of BNM and SSM on Beneficial Ownership of Legal Persons (Jointly Issued by BNM and SSM)
   iii. Others such as the FAQs for AML/CFT and TFS for DNFBPs & NBFIs, Guidance on Verification of Individual Customers for Customer Due Diligence, AML/CFT Guide, infographics, etc.

2. ML/TF Risk Assessment

A. National Risk Assessment (NRA) 2020 Executive Sumary

Alternatively, you may also access the above documents from the AML/CFT Microsite.

3. FATF-related Materials

A. High-Risk Jurisdictions subject to a Call for Action
B. Jurisdictions under Increased Monitoring
C. Guidance for a Risk-Based Approach for Legal Professionals

Should there be any need to obtain further clarification or explanation on the report, enquiries may be emailed to the following addresses:
i. For FIs : **amlpolicy@bnm.gov.my**
ii. For DNFBPs and NBFIs : **fied@bnm.gov.my**

Telephone: **+603-2698-8044**; Website: **https://amlcft.bnm.gov.my**