



## Post Panama Papers: Next Steps for Financial Institutions

### ACAMS

#### Overview

Protiviti, in conjunction with the Association of Certified Anti-Money Laundering Specialists (ACAMS), hosted a briefing for financial institutions on October 11, 2016, entitled “Post Panama Papers: Offshore Health Check for Financial Institutions.” This paper summarizes the issues discussed at the event.

#### Issue

The offshore financial world changed forever in April 2016 with the leak of 11.5 million documents from Mossack Fonseca (MF), a Panama-based law firm which specializes in the formation and management of entities in tax havens.<sup>1</sup> The “privacy” or “anonymity” provided to the ultimate beneficial owners (UBOs) of 214,000 offshore entities formed by MF was transformed into a publicly available database tying the UBOs to these entities.<sup>2</sup> In September 2016, the same source responsible for the Panamanian leak also leaked information from the Bahamas corporate registry.<sup>3</sup>

Links to offshore companies by some 140 national and countless local politicians and others in the public eye were seized on by the press. The public outrage triggered by the press reports resulted in the resignation of the prime minister of Iceland and the Spanish minister of industry, along with many others. It also triggered governmental and regulatory interest into financial institutions’ links to MF and Panama. Although there are legitimate uses of offshore entities by individuals and enterprises, the popular press portrayed the use of offshore entities as synonymous with tax evasion, fraud and other financial crimes.

<sup>1</sup> The International Consortium of Investigative Journalists (ICIJ): <https://panamapapers.icij.org/>.

<sup>2</sup> ICIJ Offshore Leaks Database: [https://offshoreleaks.icij.org/#\\_ga=1.182108903.1501946061.1476790354](https://offshoreleaks.icij.org/#_ga=1.182108903.1501946061.1476790354).

<sup>3</sup> “ICIJ publishes leaked Bahamas info to offshore database,” ICIJ, September 21, 2016: [www.icij.org/blog/2016/09/icij-publishes-leaked-bahamas-info-offshore-database](http://www.icij.org/blog/2016/09/icij-publishes-leaked-bahamas-info-offshore-database).

## The Regulatory Response to Date

Regulators have responded to the leaks by requiring financial institutions to provide information concerning customers' links to MF and to complete additional screening steps. Investigations have been launched in numerous countries, including the United States, the United Kingdom, Germany, Australia, Sweden, Hong Kong, Chile, Singapore and India.

In certain circumstances, regulators have followed up with requests for copies of know your customer (KYC) files to assess the adequacy of the KYC standards applied, particularly with regard to the identification of UBOs and the rationale for their use of a structure registered in a jurisdiction that applies very low or no tax. To date, the regulators' focus has generally been limited to links to MF and Panama, but the further leak from the Bahamas corporate registry, noted above, has ensured that their interest will broaden to other jurisdictions and offshore formation agents. MF is only one of a large number of law firms and others that provide such services, and several jurisdictions have many more registered entities than Panama.

## Expanding Regulatory and Tax Authority Interest

Regulatory and tax authority interest in this issue is expanding beyond MF and Panama. In the UK for example, the national tax body, Her Majesty's Revenue and Customs (HMRC) issued a consultation document in late August 2016 confirming the formation of a new "multi-agency task force to tackle offshore tax evasion," which also introduces a new criminal offense to apply to corporations that "fail to prevent their representatives *from facilitating tax evasion*, where the corporation *cannot show they took reasonable steps to prevent this*."<sup>4</sup> In summary, the new measures "represent(s) a significant toughening of the government's approach to tackling offshore tax evasion and its *enablers*."<sup>5</sup>

Many other countries have launched similar tax investigations, and the European Union (EU) has formed a committee of 65 members of the European Parliament, which met for the first time in late September 2016, to investigate the implications of the leaked MF information.<sup>6</sup>

## Preparing for Ongoing Regulatory Interest

Financial institutions should be taking steps now to prepare for ongoing regulatory interest in the uses of offshore structures and companies. The list below is not intended to be exhaustive but rather to be indicative of the areas a financial institution should explore in advance of a regulatory or tax authority inspection related to customers which are, or who have links to, offshore entities.

- Financial institutions should first understand their exposure to the offshore world. This can be challenging since the term "offshore" or "tax haven" is not clearly defined. The International Monetary Fund (IMF) has published a list of offshore jurisdictions it has assessed, while the Organisation for Economic Co-Operation and Development (OECD) also has a list of jurisdictions that do not implement its standards of transparency and exchange of information.<sup>7</sup> In general, the term "offshore" encompasses jurisdictions that permit "international business companies." Such companies may not conduct business nor be taxed in the country of registration. This does not mean that such entities are not subject to tax in another jurisdiction, which is often in the country of tax residence and/or domicile of their UBOs. Judgment must be used to establish a definitive list of jurisdictions that qualify as offshore, which can be used to understand an individual organization's exposure.
- The customer risk rating calculation methodology should be adjusted to take into account any heightened risk of financial crime posed by entities established offshore.

<sup>4</sup> *Tackling Offshore Tax Evasion: A Requirement to Correct*, HM Revenue & Customs, August 24, 2016: [www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/547778/Tackling\\_offshore\\_tax\\_evasion-a\\_requirement\\_to\\_correct.pdf](http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/547778/Tackling_offshore_tax_evasion-a_requirement_to_correct.pdf).

<sup>5</sup> *Ibid.* Paragraph 2.8; p7.

<sup>6</sup> "Parliament sets up "Panama Papers" inquiry committee," European Parliament press release, June 8, 2016: [www.europarl.europa.eu/news/en/news-room/20160603IPR30203/parliament-sets-up-%E2%80%9Cpanama-papers%E2%80%9D-inquiry-committee](http://www.europarl.europa.eu/news/en/news-room/20160603IPR30203/parliament-sets-up-%E2%80%9Cpanama-papers%E2%80%9D-inquiry-committee).

<sup>7</sup> See *Offshore Financial Centers (OFCs): IMF Staff Assessments*, IMF, November 20, 2014: [www.imf.org/external/NP/ofca/OFCA.aspx](http://www.imf.org/external/NP/ofca/OFCA.aspx) and *Tax Co-operation 2010: Towards a Level Playing Field - Assessment by the Global Forum on Transparency and Exchange of Information*, OECD, fifth edition published in 2010: [www.oecd.org/tax/exchange-of-tax-information/taxco-operation2010towardsalevelplayingfield-assessmentbytheglobalforumontransparencyandexchangeofinformation.htm](http://www.oecd.org/tax/exchange-of-tax-information/taxco-operation2010towardsalevelplayingfield-assessmentbytheglobalforumontransparencyandexchangeofinformation.htm).

- The financial institution's KYC standard for understanding the client and its business must entail obtaining information on why an offshore entity is being used. Financial institutions cannot be expected to be experts relating to their customers' tax affairs (except when giving such advice), but consideration should be given as to how comfort is obtained that it is not enabling customers to evade taxes through the use of an offshore entity.
- KYC files and system data fields should be reviewed to ensure that they can readily provide the country of registration/domicile of all customer and intermediate beneficial owner (IBO) entities.
- Most significantly, KYC systems and files for offshore entities must be able to provide information on UBOs at ownership percentages consistent with the risk rating of the customer and be able to distinguish between UBOs and nominee shareholders. The use of nominee shareholders and directors is widespread in the offshore world and is often used as a mechanism to provide anonymity for the UBO.

### How does the offshore issue fit into the overall regulatory landscape?

A number of financial institutions face a range of regulatory pressures covering a multitude of prudential, governance and conduct issues. Regulatory and political attention is likely to remain focused on the uses of offshore tax havens by companies and individuals, specifically because it involves the possibility of collecting significant amounts of tax revenues. Certainly, the issue has captured public and media interest. Successfully tackling this issue could also provide significant political value to governments and regulators around the world.

### Conclusion

The offshore financial world changed significantly with the leak of the Panama Papers. Regulatory interest in the use of offshore entities will continue to grow, and financial institutions should review their KYC records, processes and systems to ensure that they are adequately prepared for further scrutiny on this topic.

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