

WHY IS THE DISCLOSURE OF BENEFICIARIES IMPORANT?

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Despite leaving the EITI in 2017, Azerbaijan declared its commitment to the EITI principles. This is confirmed in the presidential decree dated 5 April 2017¹. Clause 1 of the document states the following:

“The application of transparency and accountability standards to the extractive industry in the Republic of Azerbaijan shall be continued on the basis of the following international principles...”

According to the decree, a Commission on Extractive Industries Transparency has been established and the preparation and publication of annual Extractive Industry reports shall be continued. It is possible to say that the report for 2016 was prepared in accordance with EITI requirements².

Along with requirements, the EITI Standard 2016 also contains recommendations. One of them has to do with the disclosure of beneficial ownership. **So what is a beneficial ownership?**

Current Azerbaijan legislation does not provide a definition of this concept. At the same time, the “Key Concepts” article of the Law of the Republic of Azerbaijan “On fighting the legalization of financial resources or other property acquired in an illegal way and the financing of terrorism”³ provides the following definition of a Beneficial Owner:

1.0.12. beneficial owner – a natural person or a corporate entity which has derived economic or other benefit from the transactions involving financial resources or other property, including the actual owner of the corporate entity in whose favor such transactions have been implemented or a natural person exercising control over a customer and (or) implementing financial or any other transactions or a natural person exercising control over a corporate entity;

This concept was incorporated into the Law on 13 May 2017. The previous edition of the

¹ <http://e-qanun.az/framework/35174>

² http://www.oilfund.az/uploads/Final_EIT_ReportPublish.pdf

³ <http://e-qanun.az/framework/16347>

law did not have a definition of a beneficial owner. It only contained the definition of a beneficiary, and it was slightly different⁴. After this amendment was made to the law, the concept of a beneficiary was replaced with a beneficial owner in a number of other laws.

At present, the concept of a beneficial owner is used in a number of laws. For example:

- “On banks” (a relevant amendment to the law was made on 31.05.2018);
- “On the securities market” (a relevant amendment to the law was made on 31.05.2018);
- “On investment funds” (a relevant amendment to the law was made on 31.05.2018);
- “On post” (a relevant amendment to the law was made on 31.05.2018);
- “On insurance activity” (a relevant amendment to the law was made on 31.05.2018);
- “Code on Administrative Offences (a relevant amendment to the law was made on 13.06.2017)”.

The concept of a beneficial owner has been included not only in the laws but also in other regulatory documents. In particular, the concept of a beneficiary in the “Guide on notarial actions in the Republic of Azerbaijan”⁵ was replaced with a beneficial owner on 11.10.2017.

So, our research suggests that the concept of a beneficial owner was first used in the “On fighting the legalization of financial resources or other property acquired in an illegal way and the financing of terrorism” (on 13.05.2017).

The concept of a beneficial ownership appeared in the latter half of 2016. It is known that the new Extractive Industries Transparency Initiative (EITI) Standard was adopted in 2016. Clause 2.5 of the Standard is called Beneficial Ownership.

Therefore, the concept of Beneficial Ownership was used one year earlier than the concept of a Beneficial Owner during the translation of the Extractive Industries Transparency Initiative (EITI) Standard for 2016. The Standard provides the following definition of the concept of beneficial ownership (Clause 2.5.f.i)⁶:

A beneficial owner in respect of a company means the natural person(s) who directly or indirectly ultimately owns or controls the corporate entity.

⁴ **Beneficiary** – a natural person or a corporate entity which has derived economic or other benefit from the transactions involving financial resources or other property, as well as the actual owner of the corporate entity in whose favor such transactions have been implemented or a natural person exercising control over a customer;

⁵ <http://e-qanun.az/framework/488>

⁶ <http://www.eiti.az/index.php/az/senedler/mhsht-standarti>

In comparison with the concept of a beneficial owner (in the Law of the Republic of Azerbaijan “On fighting the legalization of financial resources or other property acquired in an illegal way and the financing of terrorism”), this concept is simpler and applied only to the owners of corporate entities. Considering the fact that the concept of a beneficial owner has already been introduced to a number of Azerbaijan regulatory documents (listed above), it would be expedient to use this concept in the documents pertaining Extractive Industries Transparency in the future. Otherwise, further amendments would have to be introduced to a number of legislative documents (laws, decisions, etc.). Legislators should probably decide on which of the two concepts to use.

Recommendations regarding the disclosure of beneficial owners (hereinafter referred to simply as beneficiaries) were first contained in the Extractive Industries Transparency Initiative (EITI) Standard 2013. A new EITI Standard was adopted in 2016 and clause 2.5 of this Standard dwells upon the issues of Beneficial Ownership. Clause 2.5a of the Standard recommends maintaining a special register of beneficial owners:

“It is recommended that implementing countries maintain a publicly available register of the beneficial owners of the corporate entity(ies) that bid for, operate or invest in extractive assets, including the identity(ies) of their beneficial owner(s), the level of ownership and details about how ownership or control is exerted. Where possible, beneficial ownership information should be incorporated in existing filings by companies to corporate regulators, stock exchanges or agencies regulating extractive industry licensing. Where this information is already publicly available, the EITI Report should include guidance on how to access this information.”

As is evident, it is important to make this register publicly available.

The Extractive Industries Transparency Initiative (EITI) Standard (clause 2.5.b) contains certain requirements pertaining to the disclosure of beneficial ownership:

- i. The EITI Report documents the government’s policy and multi-stakeholder group’s discussion on disclosure of beneficial ownership. This should include details of the relevant legal provisions, actual disclosure practices and any reforms that are planned or underway related to beneficial ownership disclosure.*
- ii. By 1 January 2017, the multi-stakeholder group publishes a roadmap for disclosing beneficial ownership information in accordance with clauses (c)-(f) below. The multi-stakeholder group will determine all milestones and deadlines in the roadmap, and the multi-stakeholder group will evaluate implementation of the roadmap as part of the multi-stakeholder group’s annual progress report.*

It is worth noting that up until April 2017 Azerbaijan (as an EITI member) followed the above-mentioned “i” provision of the EITI Standard. Likewise, while Azerbaijan was an EITI member prepared and published a multi-stakeholder roadmap for disclosing beneficial ownership information in December 2016⁷.

The EITI Standard 2016 contains provisions relating to time-limes for disclosing beneficiaries (2.5.c). In particular, as of 1 January 2020, it is required that implementing countries request, and companies disclose, beneficial ownership information for inclusion in the EITI Report. This applies to corporate entity(ies) that apply for, or hold a participating interest in an exploration or production oil, gas or mining license or contract and should include the identity(ies) of their beneficial owner(s), the level of ownership and details about how ownership or control is exerted. Any gaps or weaknesses in reporting on beneficial ownership information must be disclosed in the EITI Report, including naming any entities that failed to submit all or parts of the beneficial ownership information. Where a country is facing constitutional or significant practical barriers to the implementation of this requirement by 1 January 2020, the country may seek adapted implementation in accordance with requirement 8.1 of the EITI Standard.

So what is the attitude of the Azerbaijani Government to disclosing beneficiary information? The following facts attest to the presence of a positive or at least an attentive approach:

- In 2016, the multi-stakeholder group approved a roadmap for disclosing beneficial ownership information (some information about the roadmap will be provided below);
- The Government Commission currently supports a project on the application of this roadmap funded by the Asia Development Bank;
- In November 2017, the topic of “EITI and beneficial ownership: analysis of other countries’ experience and preparation of suggestions on applying it to Azerbaijan” was included in the grant competition announced by the State Council for Support of Non-Governmental Organizations under the President of the Republic of Azerbaijan⁸. This preparation of this article is part of a project by Partnership in Economic and Social Initiatives, the public association that won the said competition (the author was involved in the project as an expert).

⁷ <http://www.eiti.az/index.php/az/senedler/sahibliyin-yol-xeritesi>

⁸ <http://www.cssn.gov.az/news.php?id=3114&lang=az>

Therefore, it is possible to say that the Azerbaijani Government is interested in the issue of disclosing beneficiaries.

The roadmap for disclosing beneficiary information adopted in December 2016 includes the following sections⁹:

- Introduction;
- Coverage;
- Objective;
- Concept of beneficial ownership;
- Roadmap structure;
- Key activities;
- Monitoring;
- Budget;
- Content (Actions).

The Introduction of the Roadmap states that this document "... has been prepared in accordance with the recommendations of the Extractive Industries Transparency Initiative (hereinafter referred to as "EITI").

The document also states that "The key objective of the framework to disclose beneficial ownership information is to achieve greater extractive industry transparency and prevent cases of corruption and tax evasion on the part of irresponsible corporate entities".

The Actions section of the Roadmap covers 11 directions:

- 1) Link between beneficial ownership (BO) and national reform priorities;
- 2) Legal reforms required for BO;
- 3) Institutional framework for BO disclosure;
- 4) Concept of beneficial ownership;
- 5) Accountabilities of political figures;
- 6) Level of detail of information to be collected and disclosed;
- 7) Collection and openness of information;
- 8) Accuracy of submitted information;
- 9) Updatability of submitted information;

⁹ <http://www.eiti.az/index.php/az/senedler/sahibliyin-yol-xeritesi>

10) Knowledge building;

11) Monitoring.

The roadmap outlines the following actions to be under the second direction:

- To conduct discussions with the Milli Majlis (parliament) and Presidential Administration of the Republic of Azerbaijan to introduce the proposed amendments to national legislation;
- To introduce relevant amendments to the Law of the Republic “On subsurface resources” to reflect the concept of beneficial ownership and the process of disclosure of beneficial owners;
- In order to integrate the mechanism for disclosing beneficial owners into the existing register of commercial legal entities of the Ministry of Taxes of the Republic of Azerbaijan, to introduce relevant amendments to the Law of the Republic of Azerbaijan “On state registration of legal entities and the state register”;
- To prepare a draft of the proposed amendments.

According to the roadmap, the preparation of draft amendments to national legislation was to be completed at the end of June 2018. The work was to be carried out by an external legal consultant. This is being done by BDO with support from the Asia Development Bank¹⁰. The delay has been caused by Azerbaijan leaving the EITI.

Article 2 of the above-mentioned Law of the Republic “On subsurface resources”¹¹ is called “Principles for using subsurface resources”. This article contains the following principle:

- *Use of subsurface resources in the conditions of openness;*

However, no explanation is provided of such openness.

Article 8 of the said Law is called “Users of subsurface resources” and Article 9 is called “Rights and responsibilities of users of subsurface resources”. These articles do not set forth any requirements in respect of beneficiary disclosure.

Article 4 of the Law of the Republic of Azerbaijan “On commercial secrets”¹² is called “Information considered to be a commercial secret”. The article states the following:

4.1. Except for the following, the information of legal entities and natural persons consistent with the requirements of this Law is considered to be a commercial

¹⁰ <https://www.bdo.az/az-latn-az/bas-s%C9%99hi%C9%99>

¹¹ <http://e-qanun.az/framework/4273>

¹² <http://e-qanun.az/framework/2861>

secret:

4.1.1. Information representing a state secret;

4.1.2. Information stated on constituent documents (except for information on founders (participants) of a commercial legal entity and their respective shares in the charter capital);

Therefore, this Law does not consider information on beneficial ownership to be a commercial secret.

Article 18 of the Law of the Republic of Azerbaijan “On state registration of legal entities and the state register”¹³ is called “Openness of the state register”. This article says:

18.1. With the exception of information on founders (participants) of a commercial legal entity and their respective shares in the charter capital, every person has the right to become familiar with the information shown on the state register, require an extract from the state register and copies of documents submitted for registration purposes. A relevant body of executive authority of the Republic of Azerbaijan shall, upon a request by any person, provide information on whether a legal entity is or is not registered by the state.

18.2. Other information envisaged in national legislation in respect of state registration of legal entities, representative and branch offices of foreign legal entities and their inclusion on the state register, as well as incorporation and activities of legal entities (except for information on founders (participants) of a commercial legal entity and their respective shares in the charter capital) shall be published in an official state newspaper for general familiarization purposes. ^[83]

Therefore, it is this law that prevents official disclosure of beneficiaries.

International experience shows that the non-disclosure of beneficiaries by corporations takes place mainly because of their behind-the-scenes directors. This, in turn, creates favorable conditions for corruption, tax evasion and secret funding of terrorism. In fact, the disclosure of beneficiaries:

- Reduces the risk of corruption and tax evasion. If a beneficiary is a senior official, there is a higher risk that his company may obtain an unfair advantage in state purchases. This means that the state budget would incur certain losses and the overall competition environment would be compromised. This is why Azerbaijan legislation prohibits government officials to engage in business activities. Whether or not the beneficiary is a government official, non-disclosure of the beneficiary paves the way for tax evasion;

¹³ <http://e-qanun.az/framework/5403>

- Saves the persons with important political functions from the conflict of interest. This is possible only if national legislation explicitly provides for beneficiary disclosure;
- Beneficiary disclosure makes it easier for companies to access external funding, as it opens the doors to securities markets and creates favorable conditions for selling their shares;
- Investor confidence in the companies disclosing their beneficiaries increases. What investor would be the shares of an unknown or unofficial company?
- Public confidence in the companies disclosing their beneficiaries increases;
- Beneficiary disclosure reduces the risk of financing terrorism.

Is there anything in Azerbaijan's extractive industry today that is not transparent and remains hidden? Unfortunately, there still is:

- What regulatory document (law, decree, etc.) governs the selection of foreign companies selected and the signing of contracts with them? After being signed, the contracts are ratified and signed into law by the parliament, but the entire process is not governed by any legislative act. This has been practiced for many years, but whether that is sufficient is rather questionable. After all, it is not just a business area, it is associated with the exploration and production of the state's natural resources. The award of a license in this area must be governed at the most rigorous level. Such legislative probably does exist, but it is not being disclosed;
- Results of audit on oil and gas reserves. SOCAR has hired a foreign company to perform such an audit, but the results have not been disclosed. Today, Azerbaijani citizens, experts, journalists and investors, including foreign ones, have to apply to BP statistics for reliable information;
- Beneficiaries of a number of companies operating in the extractive industry (of course, this does not apply to trans-national companies whose beneficiaries are known). In some cases, the companies signing oil and gas contracts do not even have a web page.

It is extremely important to eliminate such cases.

A total of 51 countries are involved in the EITI. Multi-stakeholder groups in 50 of them have approved roadmaps for beneficiary disclosure¹⁴. All these roadmaps are available on the EITI web page ¹⁵. The roadmaps have been prepared on the basis of EITI

¹⁴ EITI Progress Report for 2018:

https://eiti.org/sites/default/files/documents/2018_eiti_progress_report_en.pdf

¹⁵ <https://eiti.org/publication-types-public/beneficial-ownership-roadmaps>

recommendations and are therefore quite similar. The key action stated on the roadmaps is to introduce changes to legislation to ensure beneficiary disclosure.

Some EITI member-countries have made great strides in beneficiary disclosure. Here is information about some of them.

Kyrgyzstan. For its efforts towards beneficiary disclosure, Kyrgyzstan received a special award of the EITI Chairman (Frederik Reinfeldt) at the “Opening up ownership” conference held in Jakarta, Indonesia, on 23-24 October 2017¹⁶. Representatives from more than 50 countries attended the conference.

The first attempt at beneficiary disclosure was made in Kyrgyzstan during the preparation of the EITI report for 2014.

Following amendments introduced to the Law “On subsurface resources”, companies operating in the country’s extractive industries are required to disclose their beneficiaries. The law also envisages serious penalties for false information. The government is currently working on a special register.

The European Bank for Reconstruction and Development (EBRD) assisted the Kyrgyz Government in preparing the roadmap. Three UK-aided training programs on beneficiary disclosure were implemented in Bishkek for: 1) members of the country’s EITI Council; 2) Representatives of the civil society; and 3) journalists. In addition, a Communication Strategy on beneficiary disclosure was adopted¹⁷. Also, on a request from the business community, law firm Kalikova & Associates performed a risk analysis on beneficiary disclosure. After reviewing the results, stakeholders said that beneficiary disclosure would not cause any insurmountable risks.

Kazakhstan, too, introduced amendments to its Code “On subsurface resources” and compelled oil, gas and mining companies to disclose their beneficiaries¹⁸. In other words, any company applying for a license is required to disclose its beneficiaries and provide updates if the beneficiaries change. The country launched the pilot application of the law in its 2016 report.

Ukraine. This country has introduced the world’s first register of beneficial ownership of legal entities and a special register of government officials’ assets¹⁹. The Government

¹⁶ https://eiti.org/sites/default/files/documents/2018_eiti_progress_report_en.pdf

¹⁷ https://eiti.org/sites/default/files/documents/eiti_botmilestones_8.pdf

¹⁸ https://eiti.org/sites/default/files/documents/2018_eiti_progress_report_en.pdf

¹⁹ <https://usr.minjust.gov.ua/ua/freesearch>

started this work, which covers all companies, in 2014. So far, 70 percent of the companies have been covered (including the extractive industry). All information is public and easily accessible. The register is updated by the Ministry of Justice. The Government of Ukraine received a “Mark of Distinction” at the “Opening up ownership” conference held in Jakarta, Indonesia, on 23-24 October 2017.

Mongolia. The first attempt at beneficiary disclosure was made during the preparation of the EITI report for 2013²⁰. The multi-stakeholder group suggested to 250 companies that they disclose the beneficiaries possessing an interest share of more than 5 percent. 215 companies did that. In the following years, fewer companies disclosed their beneficiaries. In particular, in 2016 only 47 of 213 companies disclosed their beneficiaries. According to the roadmap, the Report for 2018 (to be released in 2019) shall disclose the beneficiaries of all companies. The issue of beneficiary disclosure has been included in the 2017-2023 National Anti-Corruption Program and the State Policy on Mineral Resources for 2014-2025²¹.

Albania. During a global EITI conference held in Lima in 2016, the Albanian energy minister stated that the Albanian Government was in favor of beneficiary disclosure. In 2017, the Albanian EITI Secretariat prepared a draft EITI law, which requires beneficiary disclosure. The law is expected to be adopted. During the preparation of the EITI report for 2015, a total of 134 companies were offered to disclose their beneficiaries. Of these, only 31 submitted the information. In 2016, the Albanian EITI Secretariat conducted a survey among Albanian citizens, asking two questions: 1) Are the actual owners of companies known to you? 2) Do you think that companies are concealing their actual owners? The results of the survey showed that citizens think that companies are actually owned by politicians²².

UK. In order to encourage disclosure of beneficiary information, amendments were introduced to national legislation in 2015, which resulted in the creation of the world’s biggest register of beneficial ownership (persons controlling companies)²³. The register has an interesting name: “Persons with Significant Control”. It covers close to 4 million companies registered in the United Kingdom, and is open and easily accessible. The register was developed in accordance with the UK Law “On small businesses, entrepreneurship and employment” in June 2016. To date, 2 billion people have accessed the register. The register is part of the “Companies House”²⁴ register. The disclosure of

²⁰ <https://eiti.org/mongolia#beneficial-ownership-disclosure>

²¹ https://eiti.org/sites/default/files/documents/eiti_botmilestones_8.pdf

²² https://eiti.org/sites/default/files/documents/eiti_botmilestones_8.pdf

²³ <https://eiti.org/united-kingdom>

²⁴ <https://www.gov.uk/government/organisations/companies-house>

this information allowed civil society the opportunity to conduct their evaluations and find errors for the Government to correct, which will improve the accuracy of the database. The UK Government received a “Mark of Distinction” at the “Opening up ownership” conference held in Jakarta, Indonesia, on 23-24 October 2017.

Again, all EITI countries have approved roadmaps on beneficiary disclosure, and there are plans to disclose all beneficiaries by 1 January 2020. Civil societies of all the countries have been heavily involved in the preparation of roadmaps and the overall disclosure of beneficiaries.

It is also worth noting that beneficiary disclosure is not only in the best interest of the EITI. It is of global nature. And the reasons have been described above.

Article 30 of the 4th EU Anti-Money Laundering Directive (4AMLD) requires member-countries to have provisions on beneficiary disclosure in their laws, stating that accurate information as of 16 November 2016 must be reflected in their respective registers. The next EU Directive 5AMLD (adopted on 14 May 2018 and entered into force on 9 July 2018) contains provisions regarding a centralized register²⁵. The global beneficiary register²⁶ contains publicly available and free information about 5,078,866 companies (this includes: UK PSC Register, Denmark Central Business Register (CVR), Slovakia Public Sector Partners Register, Ukraine Unified States Register (EDR) and EITI pilot data).

It is worth mentioning that the criterion for including a certain beneficiary into the beneficiary register (registers) is the participating interest in a company. This percentage varies in different countries: from 5 to 25 percent. We believe that if this criterion is above 10 percent, this increases the risk of actual owners concealing themselves.

To conclude, countries of the world have made major progress in disclosing beneficiaries. Can Azerbaijan remain on the sidelines of this process? Should it? We believe that it should not, as our countries should evolve alongside civilized countries. We believe that the following is important:

1. It is necessary to introduce amendments to the Law of the Republic of Azerbaijan “On state registration of legal entities and the state register” and ensure that information about founders (participants) of commercial legal entities and their interest shares in the charter capital is publicly available.

If such an amendment is introduced, the beneficiary disclosure requirement will apply to all companies regardless of the nature of their activity. If that is not possible and the decision is made to apply beneficiary disclosure only to extractive

²⁵ <http://data.consilium.europa.eu/doc/document/ST-5116-2015-ADD-2/en/pdf>

²⁶ <https://register.openownership.org/>

industry companies, then it would be possible to introduce amendments only to the Law “On subsurface resources”;

2. During talks with extractive industry companies, special attention should be paid to whether information about its beneficiaries is in the public domain. Agreements should not be signed with companies whose beneficiaries are not known;
3. Considering the fact that the concept of beneficial owner is already used in a number of legislative acts, it would be appropriate to use this term in future documents related to extractive industry transparency.
4. The media should extensively promote the importance of beneficiary disclosure;
5. Representatives of the civil society should make a call to all extractive industry companies to disclose their beneficiaries. If such a call is heard, then very good. If not, it will lead to further steps;
6. Steps should be taken towards disclosing the beneficiaries of the companies with which SOCAR has signed agreements starting from 2020;
7. Consider the possibility of declaring an amnesty for the beneficiaries of Azerbaijani companies who voluntarily disclose themselves before 2020.

We think that all these may be important steps. Along with the sustainable non-oil economy growth, the future development of Azerbaijan also depends on the application of good governance principles (transparency, accountability, rule of law, and involvement). We must not forget that.