FINANSTILSYNET

Report on survey of the involvement of Danish banks in the Panama Papers matter.

FINANSTILSYNET

Report on survey of the involvement of Danish banks in the Panama Papers matter.

1. Summary

On 19 June 2016, the Danish FSA published a preliminary status report on the involvement of Danish banks in the tax-evasion matter known as the "Panama Papers". The status report was based on preliminary material received by the Danish FSA from respondent banks to a survey conducted during May 2016.

Subsequently, the Danish FSA received more detailed reports from the majority of the respondent banks. The material collected has formed the basis of this report from the Danish FSA.

The final conclusions are in line with the conclusions presented in the June 2016 status report. The overall impression is that the number of customers involved in bank transactions which could possibly be used for tax evasion purposes[1] has declined over the 10-year-period covered by the survey. Nevertheless, the Danish FSA still finds that, during the period covered by the survey, bank managements have had insufficient focus on ensuring compliance with money-laundering regulations when dealing with such customers.

2. Background

On 3 April 2016, world media conveyed the news that 11.5 million documents had been leaked from the Panamanian law firm Mossack Fonseca. Media coverage indicated that the documents contained information concerning individuals and undertakings who had set up funds and companies with the assistance of Mossack Fonseca. One of the purposes was to hide assets from local tax authorities.

According to the media, a small percentage of the documents contained information about Danish individuals' involvement in tax evasion. Furthermore, the media coverage indicated that several Danish banks had played an active role, e.g. in establishing contact between bank customers and Mossack Fonseca, who then set up and managed the company structures described.

On this background, the Danish FSA concluded that eight selected banks were to submit reports regarding their potential involvement in the tax evasion reported in the media. The banks concerned were selected on the basis of an overall assessment of their business model.

The Danish FSA requested information from the banks documenting how the banks ensured that they were neither involved in, nor had they contributed to, customer transactions aimed

[1] Based on statements from the eight respondent banks, at least 630 customer relationships were terminated during the survey period, either on account of a direct connection to Mossack Fonseca or due to lack of documentation from customers confirming correct reporting to the tax authorities. However, the actual number of accounts closed during the survey period is probably higher, as some banks stated that they have closed foreign subsidiaries for strategic reasons. The risk of money laundering was stated as one of the reasons.

at evading payment of taxes or duties. Furthermore, the banks were asked to explain how they had approached the possible reputational risk associated with being involved in such transactions.

On the basis of the responses from the banks, the Danish FSA found it necessary to request additional information from some of the banks.

Based on the preliminary material, the Danish FSA published a status report concerning Danish banks' involvement in the Panama Papers controversy. The status report was issued on 19 June 2016.

Following the Panama Papers leak, several media reported on the involvement of Danish banks in share portfolio lending, which enables borrowers to claim refunds of withholding tax on dividends; refunds to which they are not entitled. The Danish FSA does not have the authority to take a position on any tax legislation violations. However, given the link to the Panama Papers and the possible violation of the regulations of the Money Laundering Act, the issue will be dealt with briefly in this report in the "Legal aspects" section.

3. International aspects

The European Commission has proposed an amendment of the 4th Money Laundering Directive, partly in response to the Panama Papers controversy. The amendment proposes combining national registers of beneficial owners to EU level. The aim is to increase transparency of corporate structures. Furthermore, the European Commission has proposed the establishment of a central, national register of information concerning natural and legal persons exercising control over a trust or a similar legal arrangement.

The proposal is currently being negotiated, and a final time schedule for the work has not yet been decided.

4. Elaboration of the preliminary conclusions in the status report

As described in the June 2016 status report, several of the respondent banks provided relatively brief answers to the questions from the Danish FSA. This should, however, be seen in light of the response deadline of two weeks.

Having reviewed the supplementary material from the banks, the Danish FSA maintains its assessment that the issue concerning possible tax evasion by customers primarily concerns non-Danish private-banking customers who have had bank accounts with Danish banks for various reasons. Furthermore, the Danish FSA is still of the opinion that the issue concerns a small number of customers, and that contact between these customers and the Danish banks has primarily been through the banks' foreign subsidiaries or branches. Consequently, the review of new material from the banks has not caused the Danish FSA to alter its conclusions from June 2016. Therefore, this report will primarily elaborate on the previous conclusions.

A common characteristic of the responses from the banks is that, at the time when the Danish FSA requested the reports, the banks did not have an overview of the volume of customers involved in company structures which, by their nature, caused suspicion of a risk of money

laundering. In several cases, the request from the Danish FSA caused the banks to carry out new assessments of customers with links to tax-haven countries.

Most of the banks found no reason to correct the information previously reported to the Danish FSA. However, in two cases, the banks changed the information previously reported to the Danish FSA concerning customers with links to Mossack Fonseca. During their review, the banks became aware of accounts that they had not identified when submitting their first response to the Danish FSA. In one of the cases, the request from the Danish FSA led to a separate investigation by a bank of its customer portfolio. The bank concluded that its portfolio had included a number of customers with links to Mossack Fonseca, without the bank having sufficient information about these customers to comply with the provisions in the Money Laundering Act regarding customer knowledge. However, for several of these customers, no transactions had been carried out in relation to their accounts, and most of the accounts were closed up to several years before the media coverage of the Panama Papers. Nevertheless, this does not change the fact that the bank has failed to observe its obligations pursuant to the Money Laundering Act with respect to these customers.

The information indicates that some of the respondent banks have actively attempted to attract foreign private-banking customers. These customers primarily had their accounts with the banks' foreign subsidiaries or branches. For example, one bank stated that the focus of its private-banking department was on non-Danish Western customers with exports to Denmark as well as East-European customers. The department was closed down in recent years, and the East-European customer portfolio has largely been phased out. The remaining customers at the private-banking department were primarily transferred to other parts of the bank.

Similarly, another bank stated that its foreign subsidiaries had private-banking customers from the country in which the subsidiaries were located, but that the subsidiaries also had private-banking customers domiciled in other countries. There appears to be no obvious connection (neither with the country in which the bank's subsidiary was located, nor with the country in which the bank itself was located) which would cause a third-country customer to choose this particular bank.

Many of the respondent banks emphasise in their basic values that they will not participate in or contribute to tax evasion by customers. This also applies to banks, which stated that their customer portfolio includes or has included customers with links to Mossack Fonseca.

All the respondent banks stated that they had not offered or actually provided advice on tax issues, including corporate structures such as offshore structures, which might be suitable to conceal liquid assets from the tax authorities.

The banks stated that they had instead referred their customers to tax advisors. However, in the material submitted, the banks does not describe how they have dealt with customers subsequently approaching them with requests to open accounts in tax-haven countries or to set up offshore companies. All else being equal, these customers should be considered suspicious with regard to possible tax evasion. However, several banks simply concluded that the suggestions for such suspicious corporate structures came from the customers

themselves. On the basis of information submitted by the banks, the Danish FSA concludes that in some cases, the investigation required according to the Money Laundering Act has not been performed. Thus, the banks have not provided sufficient documentation to prove that their customers' commercial motivation for opening an account has been assessed with due diligence. Similarly, in some cases, banks have made subsequent investigations of their customer relationships revealing that essential information was missing, thus causing the bank to freeze the customers' accounts.

In the opinion of the Danish FSA, it seems that the basic values described by the banks have not been sufficiently translated into specific action patterns in the banks' organisations. Consequently, the basic values formulated by the banks are not a sufficiently accurate reflection of the culture actually prevailing at the banks in question.

The respondent banks stated that, overall, their compliance functions and internal audit functions have not checked whether their customers' accounts were being used for tax evasion purposes. Once again, this indicates that banks' official basic values have not been given much weight in practice. At the same time, several respondent banks stated that, in the period from 2006 and up until today, they have closed down international subsidiaries and branches due to the risk of abuse of their services for money laundering purposes. To some extent, this may be a reflection that banks found part of their organisations to be at risk of not living up to their basic value of not contributing to tax evasion.

As mentioned previously, over the years, banks have reduced the number of customer relationships which appear suspicious with respect to possibly being associated with tax evasion. The responses from the banks indicate that a large proportion of them changed their behaviour during the ten-year period covered by the Danish FSA's survey. In the last part of the period in particular, several banks introduced more stringent controls on customers' reporting of their financial circumstances to relevant tax authorities. A few banks stated that, if customers were unable to present documentation of their reports to the tax authorities, their accounts would be frozen.

Similarly, in recent years, several banks have reassessed their relationships with customers involved in offshore company structures and terminated such customer relationships if the bank found no legitimate reason for the corporate structure.

Based on the original material, as well as the supplementary material submitted by the banks, the overall impression is that, throughout the years, bank managements have not had enough focus on what is required of them to ensure compliance with money laundering regulations.

5. General risk assessment

Based on the answers received from the banks, the overall assessment of the Danish FSA is that banks have not had adequate focus on compliance with money laundering regulations. The risk of becoming involved in tax evasion by customers has not been seen as a reputational and operational risk to a sufficient degree. This leaves the impression that money laundering and the significance of money laundering issues have not been sufficiently rooted in management practice, and consequently have not been given appropriate priority

in day-to-day operations. The banks are therefore at risk of not having adequate measures in place to ensure effective prevention of money laundering, thus complying with statutory requirements.

As an overall general risk assessment of the banking sector, the Danish FSA therefore asserts that banks should have considerably more focus on the obligations stipulated in the Money Laundering Act in order not to become directly or indirectly involved in tax evasion by customers. Bank managements should make a greater effort than they do today to create a healthy culture in their organisations. A culture that continuously supports banks in meeting their obligations pursuant to the Money Laundering Act. This is an operational task in line with other legal requirements. Today it is not possible to run a healthy and robust bank unless the management of the bank has adequate focus on the regulations in the Money Laundering Act.

6. Legal aspects

The legal basis of banks' obligations to establish adequate measures for prevention of money laundering is laid down in the Money Laundering Act.

"Money laundering" as defined by the Money Laundering Act means that a natural or legal person unlawfully accepts or acquires or obtains for others a share of an economic proceeds obtained through an offence punishable by law. Similarly, subsequently contributing to securing the economic proceeds from an offence punishable by law by unlawfully hiding, storing, transporting etc. such proceeds is also considered as "money laundering". Attempts to do the same are also covered by this definition.

Punishable violations are covered by the Criminal Code and specific legislation. The most important element in this context is that the economic proceeds are identifiable.

It follows from the Money Laundering Act that banks must meet a number of obligations aimed at ensuring that measures to prevent and guard against money laundering are effective. In brief, the obligations entail drawing up adequate internal regulations on customer identification, the obligation of attentiveness, the investigation obligation and the notification obligation. The aim is to ensure that banks have the required knowledge about their customers to be able to react if these customers intend to make transactions involving money laundering or attempted money laundering.

Transactions undertaken throughout the course of a customer relationship must be consistent with the bank's knowledge about their customer's business and risk profile, including, where necessary, the source of funds. Thus, banks are obligated to monitor continuously the circumstances of the individual customer to gain this insight.

If a bank suspects that the relevant customer's transaction or request has links to money laundering, this matter must undergo further scrutiny. If the bank is unable to fully disprove the suspicion, the bank must notify the Public Prosecutor for Serious Economic and International Crime. Thus, stating that the bank's further investigation into a matter has merely weakened the suspicion will not suffice.

The requirements of the Money Laundering Act concerning notification of suspicious transactions to the Public Prosecutor for Serious Economic and International Crime do not depend on the underlying type of criminal activity. Consequently, the requirements also cover tax evasion.

Note that this is solely a compulsory notification and not a police report.

The Danish FSA is aware that, in practice, questions may arise in relation to deciding when a transaction should be considered suspicious. Consequently, the Danish FSA wants to take this opportunity to provide further guidance on matters related to lending Danish shares, since this issue has been debated in connection with the Panama Papers.

Lending Danish shares

Lending Danish shares is a well-known type of commercial transaction supporting market liquidity and more efficient securities trading. Lending shares may also be used for speculation in declining markets, where the borrower borrows shares from the lender and subsequently sells the shares in the prospect of being able to repurchase the same amount of shares at a lower price once the shares have to be returned to the lender. The lender's only interest in such a transaction is the fee that the lender receives from the borrower in return for assuming the risk of the borrower not being able to return the shares.

Therefore, in by far the majority of cases, share lending is not in itself suspicious.

According to Danish tax legislation, the lender will still be considered the owner of the shares, even though they have been lent out. Consequently, the lender is liable to pay tax on dividends received.[1]. However, this does not apply if the borrower has resold the shares to a third party, which is often the case. In this case, the third party acquires legal ownership of the shares and will be taxed on any dividend payment[2].

Regardless of whether the borrower keeps the shares during the term of the loan or sells them on to a third party, the borrower never becomes the owner of the shares from a tax-law point of view. Thus, the borrower never becomes liable to pay Danish tax on dividends, nor does the borrower become entitled to receive a refund of the withholding tax.

In connection with lending Danish shares, the borrower is registered as the owner in VP Securities A/S. The registration is notified to the Central Customs and Tax Administration (SKAT). This opens up the possibility for the borrower to claim a refund of withholding tax on dividends to which he is not entitled. If the lender is a Danish taxpayer, and the borrower is a non-Danish taxpayer, an unlawful refund of dividend tax may reduce total taxation on dividends, depending on the double taxation agreement applicable. The "savings" achieved can be split between the lender and the borrower.

The Danish FSA does not expect regular monitoring procedures by banks under the Money Laundering Act to expose unlawful claims for refunds of dividend tax or to identify share lending transactions aimed at concealing the rightful owner of the shares. However, if a bank

[1] SKM 2010.266.SR
[2] Response from the Danish Ministry of Taxation to early warning in connection with lending of shares, 23 September 2015

becomes aware of a transaction carried out for this purpose, according to section 7 of the Money Laundering Act, the bank is obliged to notify the Public Prosecutor for Serious Economic and International Crime. Furthermore, a bank actively contributing to such transactions may incur criminal liability depending on the circumstances.

7. Purchase of data by the Central Customs and Tax Administration (SKAT)

Since the Danish FSA's status report was published in June 2016, new information has come to light regarding Danish involvement in the Panama Papers. In September 2016, SKAT purchased data material with a link to Denmark extracted from the leaked Panama Papers.

In the autumn of 2016, SKAT and the Danish FSA had a series of discussions in order to clarify whether this data should also form part of the Panama Papers survey being carried out by the Danish FSA.

SKAT purchased the data material in order to launch tax investigations of companies and individuals named in the material. Thus, the information is generally of relevance in connection with tax investigations in specific cases of tax evasion. The survey by the Danish FSA aimed at assessing Danish banks' involvement in the Panama Papers. Consequently, the survey focused on whether banks knew about or had contributed to possible tax evasion by their customers, and whether the banks had thereby neglected their obligations in relation to money laundering. Therefore, the investigations carried out by SKAT and by the Danish FSA, respectively, did not have the same basis.

After examining the nature of the comprehensive data material purchased by SKAT, the Danish FSA considers that the information acquired does not change the conclusions of this report.

Based on information from SKAT, in the assessment of the Danish FSA, the purchased information does not specifically contain new knowledge about the involvement of Danish banks in cases concerning possible tax evasion. However, it cannot be ruled out that the material may contain information about foreign branches of banks within the same group. The Danish FSA only has authority to supervise observance of money laundering regulations in Denmark. Consequently, any information about companies located in other countries falls outside the remit of the Danish FSA. However, such information may be of interest to the supervisory authorities in other countries in connection with their inspection of money laundering. SKAT and the Danish FSA will continue their discussions of the extent to which the purchased information contains such information. If so, the Danish FSA will assess whether the information should be sent to the European supervisory authorities pursuant to the regulations in the Money Laundering Act concerning passing on confidential information to supervisory authorities in other EU countries in connection with money laundering supervision activities.

8. The process moving forward

Some of the issues described above are covered by previous supervisory reactions, and the Danish FSA does not intend to take further action with respect to these issues. Nevertheless,

the final responses from the banks have encouraged the Danish FSA to select some of the respondent banks for special attention when organising future supervision of compliance with money laundering regulations. The final assessment concerning which and how many banks should be selected for inspection will be based on a risk-based assessment of the combined risk scenario for the banking sector.

If the Danish FSA receives new information concerning the involvement of Danish banks in tax evasion by customers, the Danish FSA will decide whether such information should trigger additional supervision activities.

The Danish FSA still considers the three recommendations presented in the status report to be relevant. One of the recommendations was to promote the exchange of information between SKAT and the Danish FSA. This recommendation has now been incorporated as an additional provision in the Bill on a new money laundering act which is likely to be passed by the Danish Parliament in early 2017.

Furthermore, the status report recommended an analysis of whether the Panama Papers give reason to change the legislative basis for financial undertakings, such that stricter demands be placed on financial undertaking managements. The final recommendation was to add additional resources to the supervisory activities carried out by the Danish FSA in accordance with the Money Laundering Act. The Danish FSA concludes that the supplementary material provided by the banks does not suggest that any additional specific measures are necessary.

Translation from original text in Danish. In case of discrepancies, the Danish version prevails.