

**TA-9106 AZE: SUPPORTING THE IMPLEMENTATION OF THE  
ROADMAP FOR BENEFICIAL OWNERSHIP DISCLOSURE FOR THE  
EXTRACTIVE INDUSTRIES IN AZERBAIJAN (49451-001)**



**Report III: Draft Beneficial Owner Definition**

**Prepared for:**

**THE STATE OIL FUND OF THE REPUBLIC OF AZERBAIJAN  
(IMPLEMENTING AGENCY)**

**Under the Auspices of:**

**THE MINISTRY OF FINANCE OF THE REPUBLIC OF AZERBAIJAN  
(EXECUTING AGENCY)**

**Prepared by:**



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## Executive Summary

### Introduction

1. BDO Azerbaijan LLC (BDO), Engaged Consulting Ltd, United Kingdom, and Michael Barron Consulting Ltd, United Kingdom, (together referred to as the “Consultants”) are pleased to present this report setting out a recommended draft beneficial ownership definition (Report III) in support of the implementation of Azerbaijan’s Roadmap for Beneficial Ownership Disclosure (RBOD).
2. The Asian Development Bank (ADB) is funding the current project following a request from the State Oil Fund of the Republic of Azerbaijan (SOFAZ) as Implementing Agency under the auspices of Azerbaijan’s Ministry of Finance (MOF) as Executing Agency, to support the implementation of further transparency measures in the country’s extractive industries. ADB selected the Consultants led by BDO to undertake the RBOD implementation project.
3. This report builds on the review of International Good Practice for Beneficial Ownership Disclosure Systems contained in Report II (International Good Practice for Beneficial Ownership Disclosure Systems) dated 21 September 2018. Report III seeks to address those relevant components of beneficial ownership disclosure as specified in Report II subparagraphs 3.1 a. (definition, including criteria to determine a beneficial ownership, any exemptions and the threshold for disclosure), 3.1 b. (disclosure details, including politically exposed persons [PEPs], such as name, address, nationality and other details as well as whether PEPs are specifically included and how they are defined) and 3.1 c. (categories of companies targeted for reporting).
4. This report addresses the key issues identified in paragraph 3 above by:
  - providing the background to the current international focus on beneficial ownership disclosure regimes;
  - considering policy objectives that may influence the drafting of an appropriate definition;
  - summarizing the key elements of a beneficial ownership definition compliant with international good practice; and
  - specifying the range of options for each constituent element of that definition, referencing selected comparator countries (i.e. Australia, Indonesia, the Kyrgyz Republic, Mongolia, the United Kingdom [UK], Ukraine and Zambia), as well as relevant provisions set out by international institutions and initiatives, such as the Extractive Industries Transparency Initiative (EITI), the European Union (EU) and the Financial Action Task Force (FATF).
5. In addition, Report III also describes Azerbaijan’s existing legislation that includes a beneficial ownership definition and analyses options for introducing the proposed beneficial ownership definition described in this report. It provides a reasoned recommendation as to the content and drafting of a revised beneficial ownership definition which the Government of Azerbaijan (GOA) might adopt and briefly identifies a variety of other issues that will need

considering when implementing a mandatory beneficial ownership disclosure regime once the core definition has been agreed.

## Summary and Conclusions

6. Various pieces of existing Azerbaijani legislation<sup>1</sup> and government declarations have set high-level policy goals that are driving the introduction of a mandatory beneficial ownership disclosure regime and make it clear that GOA has a stated goal of also increasing transparency in the extractive industries operating in Azerbaijan. A key part of this agenda is the introduction of a mandatory beneficial ownership disclosure regime, including a definition of “beneficial ownership” for the extractive sector which supports the higher objectives of attracting additional investments in the country’s extractive and other sectors, while preventing undesired activities.<sup>2</sup>
7. The 2009 Law of the Republic of Azerbaijan On the Prevention of the Legalization of Criminally Obtained Funds or Other Property and the Financing of Terrorism<sup>3</sup> (or the anti-money laundering law [AML Law]) initially introduced definitions for “beneficial owner” and “politically exposed persons” into Azerbaijani law. These definitions are based on FATF’s model definitions intended for financial regulatory purposes (specifically anti-money laundering and prevention of terrorism financing) and have since been incorporated in the 2010 Law on Investment Funds<sup>4</sup> and the 2015 Law on the Securities Market<sup>5</sup> (together with the AML Law hereinafter referred to as the “Laws”).
8. Whilst it would be desirable to use a uniform definition for a multi-sector mandatory beneficial ownership disclosure regime, existing Azerbaijani law definitions do not satisfy the more onerous minimum criteria based on international good practice for ownership transparency in the extractive sector. Although it would be possible to amend the existing Laws so that they would also meet international good practice for extractive sector beneficial ownership transparency purposes, the establishment of a separate beneficial ownership disclosure regime for the extractive industries based on the use of a set of more suitable definitions may be merited.<sup>6</sup>
9. Moreover, discussions with relevant stakeholders during the Inception Mission meetings in June 2018 suggested that the most pragmatic way forward would probably be to leave the Laws as they are, while adopting a new beneficial

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<sup>1</sup> See paragraph 2.2 below for further details.

<sup>2</sup> Examples of such undesired activities are tax evasion and other criminal activities, non-transparent tendering processes that increase cost recovery under production sharing agreements (PSAs) at the expense of the state budget, decreasing public sector and private sector investor and lender confidence.

<sup>3</sup> <http://www.fiu.az/eng/wp-content/uploads/2014/10/AML-CFT-law-1.pdf>

<sup>4</sup> <http://www.e-qanun.az/framework/20760>

<sup>5</sup> <http://www.e-qanun.az/framework/30333>

<sup>6</sup> See Chapter 4.

ownership definition that meets international good practice and applying a new mandatory disclosure regime – at least initially – to the extractive sector only.<sup>7</sup>

10. When considering what this new definition might consist of, it should be noted that there is no single, standardized, definition of “beneficial owner” or “beneficial ownership” underpinning mandatory beneficial ownership disclosure regimes in the extractive sector. However, the essential elements (i.e. a clear definition incorporated into law, reference to natural persons, coverage of ownership and control, addressing both direct and indirect ownership, exemptions for specific circumstances, a reporting threshold and provisions relating to PEPs) are consistently recognized by institutions such as FATA, G20, and the EITI, as well as in national legislation that has been, or is in the process of being, introduced.<sup>8</sup>
11. In this report, the Consultants have recommended a set of definitions that are in line with international good practice and GOA’s stated policy goals. The Consultants have also identified various alternatives that may be considered to reflect other (secondary) policy goals, such as ensuring that the administrative burden is proportional to the purpose of servicing the public interest and that legitimate concerns about personal safety are adequately addressed.<sup>9</sup>
12. Azerbaijan has a unique opportunity to become a thought leader in this area by introducing a mandatory beneficial ownership regime at a time when there is substantial institutional guidance and there are suitable examples of emerging international good practices, albeit that its approach and drafting remain flexible. Based on the recommendations and possible alternatives presented in this Report III, it is now for all relevant stakeholders, whether governmental bodies or non-governmental organizations, corporate business or individuals, or otherwise to consider them carefully. The next step will be to engage all stakeholders in a consultative process aiming to guide the GOA’s decision-making authorities in their way forward while ensuring the best achievable broad-based support.

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<sup>7</sup> The extractive sector represents roughly 45% of the Azerbaijani economy (see <https://www.nordeatrade.com/en/explore-new-market/azerbaijan/economical-context>) but consists of a limited number of upstream players (see Appendix 3 for a list of the companies involved in the upstream sector). A regime limited to the extractive sector would therefore have a significant impact with only limited administrative overhead and burden.

<sup>8</sup> Even when key aspects are missing from national legislation (e.g. Zambia’s legislation lacks a PEP reporting requirement), this is recognised as an exception to generally accepted international good practice.

<sup>9</sup> See recommendations in e.g. paragraphs 5.15, 5.16, and 7.14.

## Glossary of Abbreviations and Acronyms

ADB	Asian Development Bank
AML Law	Law of the Republic of Azerbaijan On the Prevention of the Legalization of Criminally Obtained Funds or Other Property and the Financing of Terrorism
AMLD4	EU's Fourth Anti-Money Laundering Directive
AMLD5	EU's Fifth Anti-Money Laundering Directive
BDO	BDO Azerbaijan LLC
CSOs	Civil society organizations
DNFBP	Designated Non-Financial Business or Profession
GOA	Government of Azerbaijan
EITC	Extractive Industries Transparency Commission
EITI	Extractive Industries Transparency Initiative
EU	European Union
FATF	Financial Action Task Force
MOF	Ministry of Finance
MSG	EITI Multi-stakeholder Group
OECD	Organisation for Co-operation and Economic Development
PEPs	Politically exposed persons
PSA	production sharing agreement
RBOD	Roadmap for Beneficial Ownership Disclosure
SOFAZ	State Oil Fund of the Republic of Azerbaijan
SPV	Special purpose vehicle
TORs	Terms of reference
UK	United Kingdom

## 1. Introduction and Background

- 1.1. The Consultants are pleased to present this Report III setting out options and making recommendations for the proposed draft beneficial ownership definition to support the RBOD implementation in Azerbaijan. This report builds on Report II (International Good Practice for Beneficial Ownership Disclosure Systems) dated 21 September 2018 and is produced in line with the TORs and Report I (Inception Report) dated 20 August 2018.
- 1.2. ADB is funding the project following a request from SOFAZ as Implementing Agency under the auspices of Azerbaijan's MOF as Executing Agency, to support the implementation of further transparency measures in the country's extractive industries. ADB selected the Consultants led by BDO to undertake the RBOD implementation project.

### a. The Problem of Undisclosed Beneficial Ownership

- 1.3. Incorporated legal vehicles such as limited liability companies play an essential role in the extractive industries and the economy more generally, providing suitable structures to: (i) attract funding from public and/or private sector investors and/or lenders; (ii) establish well understood governance arrangements; and (iii) cap investor and lender liabilities in high-risk and volatile industries. This is certainly applicable to Azerbaijan's upstream oil and gas segment of the extractive sector where participants holding interests in production sharing agreements (PSAs)<sup>10</sup> typically operate via legally incorporated special purpose vehicles (SPVs) (see Appendix 3).
- 1.4. The use of SPVs and/or opaque investment vehicles, however, can also be deliberately used to disguise the identity of parties involved in illicit activities,<sup>11</sup> contributing to tax evasion, money laundering, bribery, conflict of interest, corruption and terrorism financing. This is achieved through mechanisms such as the use of shell companies, complex ownership and control structures, bearer shares<sup>12</sup>, share warrants<sup>13</sup> and nominee shareholders<sup>14</sup> whereby the nominator is not disclosed. The exploitation of these mechanisms results in numerous negative consequences – it may

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<sup>10</sup> And most recently risk service agreements as well.

<sup>11</sup> For example, disguised beneficial ownership was used to fraudulently move \$6 billion from Kazakhstan's BTA Bank in what is the largest case of financial fraud known in the country's history (<https://thediomat.com/2018/02/the-ablyazov-affair-fraud-on-an-epic-scale/>). See also FATF/Egmont report July 2018 <http://www.fatf-gafi.org/media/fatf/documents/reports/FATF-Egmont-Concealment-beneficial-ownership.pdf>

<sup>12</sup> Bearer shares are equity securities wholly owned by whoever holds the stock certificate, without any requirement for registration making ultimate ownership of the entity to which they relate very hard to identify.

<sup>13</sup> Share warrants are similar to share options entitling the holder to purchase shares in the underlying company, and are generally transferable without registration. They can therefore give an undisclosed holder significant influence.

<sup>14</sup> Nominee shareholders are individuals or companies that hold the legal title to shares on behalf of a third party, who is ultimately exercising influence and receiving the economic benefits from the shares.

result in gains for criminals (e.g. by avoiding tax payments), it may incur direct financial losses to the Azerbaijani economy (e.g. non-receipt of tax payments, increased cost recovery under PSA's as a result of inefficient tendering, etc.) and the undermining of public and private sector investor and lender confidence. These mechanisms may also adversely affect public confidence and the perceived legitimacy of business/company regulatory processes and the tax system, thereby, undermining the "3 T's" (fairer taxes, greater transparency and more trade) identified by former UK Prime Minister, David Cameron, as key to sustainable economic growth in his speech delivered at the G8 Open for Growth Conference on 15 June 2013.<sup>15</sup>

- 1.5. To ensure compliance with laws against such activities, relevant authorities need to be able to identify both the entities and individuals that control and benefit from the business activities of an entity and also understand how those individuals and entities are connected to each other. Similarly, commercial organizations operating in competitive markets will want to ensure that they are operating on a level playing field where competitors are not given preference on the grounds of undisclosed conflicts of interest. Both these objectives are undermined if there is deficient information collected on the beneficial ownership of companies, and the individuals involved in such illicit activities are therefore able to hide behind complex legal structures. FATF summarized this succinctly in its statement reinforcing this concept:

*"...The fundamental principle is that countries should ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities ..."*<sup>16</sup>

- 1.6. Improving the collection and utilization of beneficial ownership information is fundamental to authorities' efforts to combat and prevent illicit activities and to identify and address otherwise undisclosed conflicts of interest. This in turn promotes greater integrity and transparency within the domestic and global investment climate and overall business environment.
- 1.7. Internationally, there is an increasing focus on the transparency of beneficial ownership information, and international bodies such as the G20 view transparency as playing a key role in combating illegal activities, such as money laundering, bribery and corruption, conflicts of interests, insider trading, tax fraud and terrorism financing. This was reflected in the G20 High-Level Principles on Beneficial Ownership Transparency.<sup>17</sup> Other international initiatives and organizations, such as FATF, the Global Forum on Transparency and Exchange of Information for Tax Purposes of the Organisation for Co-operation and Economic Development (OECD) and

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<sup>15</sup> <https://www.gov.uk/government/speeches/prime-ministers-speech-at-g8-open-for-growth>

<sup>16</sup> See <http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-transparency-beneficial-ownership.pdf> page 23.

<sup>17</sup> See: [https://www.g20.org/sites/default/files/media/g20\\_high-level\\_principles\\_on\\_beneficial\\_ownership\\_transparency.pdf](https://www.g20.org/sites/default/files/media/g20_high-level_principles_on_beneficial_ownership_transparency.pdf)



multilateral development banks (e.g. World Bank and ADB) also have a strong interest in progressing work to help increase beneficial ownership transparency.

- 1.8. In early 2016, international focus on the availability of beneficial ownership information of entities and individuals, as well as of legal structures connecting them, increased following the leaks of incriminating data from a large Panama based international law firm arguably expert in creating non-transparent corporate structures.<sup>18</sup> In May 2016, beneficial ownership transparency was a key discussion topic at the Anti-Corruption Summit in London, where several countries made commitments to help increase transparency in relation to beneficial ownership.

#### **b. The Benefits of Mandatory Beneficial Ownership Disclosure**

- 1.9. As described in Report II (International Good Practice for Beneficial Ownership Disclosure Systems), beneficial ownership disclosure is key to:
- a. building trust and confidence in the integrity of the extractive industries sector for citizens, government, domestic and international industry players, investors and lenders;
  - b. addressing demands for beneficial ownership transparency from investors and finance providers to satisfy their Integrity Due Diligence and Know Your Client requirements;<sup>19</sup>
  - c. giving governments easily accessible and reliable information needed to combat tax evasion, corruption, money laundering, terrorism financing, etc.;
  - d. enhancing accountability and allowing stakeholders to ascertain who really controls and/or benefits from the extractive industries' revenues;
  - e. preventing undisclosed conflicts of interests, especially those concerning PEPs; and
  - f. ensuring stakeholders have a clear view of who is investing in and controlling their national extractive industries sector.
- 1.10. The Global Financial Crisis of 2007-2008 and the subsequent recession served to focus attention on beneficial ownership from governments, regulators and international organizations as recession-hit governments sought to crack down on tax evasion. These governments came to view beneficial ownership regimes as a tool for improving tax collection, for

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<sup>18</sup> The Panama Papers involving Mossack Fonseca (<https://www.theguardian.com/news/2016/apr/08/mossack-fonseca-law-firm-hide-money-panama-papers>).

<sup>19</sup> As confirmed during meetings with e.g. the European Bank for Reconstruction and Development, World Bank and key ministries during the Consultants' Inception Mission in Baku in June 2018.

preventing a breakdown in confidence in governmental and financial institutions, and avoiding civil unrest as later displayed in the Arab Spring.

- 1.11. In June 2013, during the UK's G8 Presidency, then British Prime Minister David Cameron spoke of the "golden thread" of trade, tax and transparency and specifically referenced beneficial ownership, stating that "It also means transparency about who owns which companies and who benefits from it – so called beneficial ownership."<sup>20</sup> During the following years, G20 issued its High-Level Principles on Beneficial Ownership Transparency<sup>21</sup> and FATF issued its Transparency and Beneficial Ownership.<sup>22</sup> Subsequently, EITI was influenced when drafting its own beneficial ownership definition and guidance.<sup>23</sup> In December 2014, the EU agreed updated anti-money laundering legislation that obliged each member state to introduce a beneficial ownership register.
- 1.12. Following conclusion of EITI's pilot project on beneficial ownership disclosure that ran between October 2013 – October 2015, and the 2016 update of its standard, EITI required its member countries to produce a roadmap and then introduce a beneficial ownership disclosure regime by 1 January 2020 (see Report II for details). Azerbaijan, which at that point continued to be an EITI implementing country, completed and submitted its RBOD for the extractive industries in Azerbaijan in December 2016.
- 1.13. Despite Azerbaijan's withdrawal from EITI on 10 March 2017 there has been subsequent high-level confirmation by GOA that it remains committed to continuing revenue transparency activities in relation to Azerbaijan's extractive industries and on 5 April 2017 the President of the Republic of Azerbaijan signed a Decree "On additional measures to increase accountability and transparency in the extractive industries".<sup>24</sup> This decree states that all extractive industry information should be disclosed to its full extent in line with international standards. Pursuant to this Decree, the Extractive Industries Transparency Commission (EITC) was established under the auspices of SOFAZ which also houses the EITC Secretariat to provide technical and organizational support.
- 1.14. EITC has established a new framework for the implementation of transparent reporting processes and all relevant parties, including civil society organizations (CSOs), are actively involved. ADB is funding the current project (including this Report III) in support of EITC's ongoing work.
- 1.15. As Azerbaijan seeks to continue attracting significant investment and financing to further develop its oil, gas and mining sectors, it needs to meet

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<sup>20</sup> <https://www.gov.uk/government/speeches/prime-ministers-speech-at-g8-open-for-growth>

<sup>21</sup> [https://www.g20.org/sites/default/files/media/g20\\_high-level\\_principles\\_on\\_beneficial\\_ownership\\_transparency.pdf](https://www.g20.org/sites/default/files/media/g20_high-level_principles_on_beneficial_ownership_transparency.pdf)

<sup>22</sup> <http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-transparency-beneficial-ownership.pdf>

<sup>23</sup> Including EITI's Board recommendation of May 2013 that beneficial ownership disclosure forms part of the EITI standard.

<sup>24</sup> <http://e-qanun.az/framework/35174> see also <http://e-qanun.az/framework/35174> for a discussion.

growing global expectations of enhanced governance, increased accountability and greater transparency, including in relation to beneficial owners of companies operating in the extractive industries sector. Azerbaijan has been and will be in competition with many other countries to attract such investment and financing, and countries that offer more transparency are likely to be more successful in doing so.

### **c. Purpose and Scope of the Report**

- 1.16. The purpose and scope of Report III are as set out in the agreed TORs attached to Report I (Inception Report) dated 20 August 2018. The purpose of this report is to provide a recommended definition of “beneficial ownership” that is consistent with Azerbaijan’s stated policy goals and national objectives, as well as with its legal and regulatory systems, and that is pragmatically capable of being implemented.
- 1.17. This report also lists various alternative approaches for specific key elements of the definition. The aim is to provide key stakeholders with a platform from which they can agree the substance of the essential elements of the beneficial ownership definition as part of a consultation process that it is proposed will occur in February 2019.
- 1.18. Based on the decisions expected to be made in February 2019 and resulting from the preceding thorough stakeholder consultation process, further work will be undertaken by the Consultants on consequential issues, such as the precise drafting of enabling legislation, means of implementation and necessary mechanisms needed to operate, validate and enforce the newly proposed beneficial ownership disclosure regime.
- 1.19. Whilst the detailed consideration of the matters specified in paragraph 1.18 above are outside the scope of this report, some of the more key consequential issues are flagged in Chapter 7 of this report for strategic change management purposes and as it may be useful to seek initial views on them in the upcoming stakeholder consultation processes.
- 1.20. The report is structured as follows:
  - Chapter 1 sets out the background to the growing support for the introduction of mandatory beneficial ownership reporting and disclosure regimes, both from international organizations and from other countries within and outside the region;
  - Chapter 2 follows on by providing a summary of some of the policy drivers and national goals that have led to this international movement and that drive the specific approaches adopted by sovereign nations to date;
  - Chapter 3 briefly summarizes the constituent elements of any beneficial ownership definition by: (i) presenting their application to prevailing or developing beneficial ownership disclosure regimes in comparator

countries and international organizations/initiatives; (ii) highlighting similarities and providing pros and cons for any differences in application; and (iii) providing an overview of the recommended application for the proposed beneficial ownership application for Azerbaijan's extractive industries (to be substantiated in Chapter 5 taking in account Azerbaijan's existing legal context);

- Chapter 4 provides a summary of relevant Azerbaijani legislation, including the existing regime relating to beneficial ownership before explaining why the Consultants recommend that the government adopts a broader definition for the purpose of RBOD implementation for the country's extractive industries;
- Chapter 5 considers the constituent elements of any beneficial ownership definition before providing the recommended approach for Azerbaijan, in line with international good practice. Alternatives for each issue are also provided together with a reasoned explanation of why they are considered less appropriate than the core recommendation;
- Chapter 6 sets out the proposed beneficial ownership definition;
- Chapter 7 provides a preview of the upcoming consultation process on the beneficial ownership definition, as well as on other matters that will need consideration during the later stages of the RBOD implementation assignment, including making a choice between the two possible options to legislate the adopted beneficial ownership regime through either amendment of existing legislation or through enactment of newly drafted stand-alone legislation; and
- Chapter 8 provides a summary of conclusions.

In support of the above:

- Appendix 1 sets out a range of options relating to the proposed beneficial ownership definition;
- Appendix 2 provides the prevailing beneficial ownership definition currently incorporated in Azerbaijani law; and
- Appendix 3 sets out a list of the major contractors in Azerbaijan holding extractive ownership interests/rights.

1.21. The report will allow relevant stakeholders (including MOF and other relevant line ministries, SOFAZ, EITC, extractive industries players and CSOs to understand the range of options available to them in identifying a beneficial ownership definition that both meets the Azerbaijani policy objectives (including compliance with international good practice) and is practical in the Azerbaijani context.

## 2. Policy Considerations Relevant for the Introduction of a National Beneficial Ownership Disclosure Regime

2.1. Any new legislation addressing the need for a national beneficial ownership disclosure regime must address national concerns in a way that meets government policies and priorities. The EITI Standard introduced in 2016 recognizes this and requires that EITI reporting countries set out their government's policy as a precursor to the publication of any roadmap and implementation of the disclosure of beneficial ownership information by the deadline of 1 January 2020. Despite Azerbaijan's withdrawal from EITI, it is apparent that the Government remains committed to revenue transparency reporting activities relating to the country's extractive industries, including the disclosure of beneficial ownership.

2.2. Key pieces of relevant recent Azerbaijani legislation and government declarations demonstrating this continued commitment include:

- a. the Beneficial Ownership Roadmap for the Extractive Industries in Azerbaijan (the "Roadmap") issued in December 2016;<sup>25</sup>
- b. the "National Action Plan on Promotion of Open Governance in 2016-2018" (the "National Action Plan");<sup>26</sup> and
- c. the preamble to the Decree of the President of the Republic of Azerbaijan on Additional Measures on Increasing Transparency and Accountability in the Extractive Industry dated 5 April 2017 (the "Transparency Decree"),<sup>27</sup>

all of which explicitly support transparency in the extractive industries, whilst recognizing that further work is needed to achieve this aim.

2.3. The focus, content and detailed design of a generally accepted beneficial ownership regime is likely to be driven by competing policy aims<sup>28</sup> and power ratios among key stakeholders, including a desire to:

- a. improve the investment climate and public trust in business;<sup>29</sup>
- b. reduce reputational and other risks and comply with international treaty and other obligations;

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<sup>25</sup> [https://eiti.org/sites/default/files/documents/beneficial\\_ownership\\_roadmap\\_-\\_azerbaijan.pdf](https://eiti.org/sites/default/files/documents/beneficial_ownership_roadmap_-_azerbaijan.pdf)

<sup>26</sup> <http://www.e-qanun.az/framework/32647>

<sup>27</sup> <https://president.az/articles/23288>

<sup>28</sup> A summary of the stated policy goals of various implementing countries can be found in Annex 3 to a report prepared by Kalikova & Associates (Analytical Note – implementation requirement for the disclosure of information about beneficial owners in the mining sector in the Kyrgyz Republic). Available directly from Kalikova & Associates who are contactable at <http://www.k-a.kg/>

<sup>29</sup> See also UK Gov "Transparency and Trust: Government Response" [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/304297/bis-14-672-transparency-and-trust-consultation-response.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/304297/bis-14-672-transparency-and-trust-consultation-response.pdf)

- c. prevent corruption and illicit financial transactions;
- d. improve the rule of law;
- e. protect the integrity and transparency of financial systems;<sup>30</sup>
- f. increase trust and accountability in government and the civil service;
- g. enhance revenue collection;<sup>31</sup>
- h. protect privacy, especially where the person or persons concerned may be at risk resulting from any beneficial ownership disclosure; and
- i. prevent conflicts of interest due to the undue influence (e.g. licensing and/or contracting extractive industries).

2.4. In summary, the collection and subsequent disclosure of beneficial ownership information is increasingly accepted as good international practice meeting rising expectations of transparency and good governance from multilateral institutions and initiatives, public and private sources of domestic and international funding and investment, as well as from civil society in general.

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<sup>30</sup> [https://www.g20.org/sites/default/files/media/g20\\_high-level\\_principles\\_on\\_beneficial\\_ownership\\_transparency.pdf](https://www.g20.org/sites/default/files/media/g20_high-level_principles_on_beneficial_ownership_transparency.pdf)

<sup>31</sup> See EITI Secretariat “Beneficial Ownership “Revealing who Stands Where” April 2016.

### 3. Constituent Elements of a Beneficial Ownership Definition

- 3.1. As described in detail in Report II, there are various issues that need to be addressed if a mandatory beneficial ownership disclosure regime is to be successfully introduced. These issues involve the following relevant components of beneficial ownership disclosure:
- a. definition of what a “beneficial owner” is, including criteria to determine beneficial ownership (including that of PEPs, any exemptions and the threshold for disclosure);
  - b. details to be disclosed about a beneficial owner such as size of interest, name, address, nationality, etc.;
  - c. scope, data collection and disclosure mechanisms, the categories of companies in scope for reporting, how data is collected and then reported (e.g. through a company register and whether it is publicly available and free to access);
  - d. verification process and sanctions for failure to report or for reporting misleading information; and
  - e. legislative process used to enact beneficial ownership disclosure, including the addressing of any legal impediments in order to avoid uncertainty.
- 3.2. This Report III addresses issues in relation to the relevant components listed under sub-paragraphs 3.1.a., 3.1.b. and 3.1.c. (the categories of companies in scope for reporting) above.
- 3.3. Although there is no single, universally applied, definition of “beneficial ownership” there is a strong degree of alignment amongst the definitions used in the comparator countries and those developed by international institutions. Key elements of any such definition can be summarized as follows:
- a. the definition (and the mandatory beneficial ownership disclosure regime more generally) must be clear, concise and legally binding;
  - b. a beneficial owner will generally be an individual natural person but might also be a government entity or a company listed on a recognized stock exchange;<sup>32</sup>
  - c. a beneficial owner can exercise ownership either directly or indirectly through a series of legal entities;
  - d. beneficial ownership covers ownership, economic interest and control, meaning that it also includes persons who may not own any shares in a

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<sup>32</sup> Recognised stock exchanges typically have their own disclosure obligations which effectively ensure that significant shareholders with interests above a specified threshold must be publicly disclosed. For example, see the UK Financial Services Authority’s (“FSA”) Transparency Obligations Directive (Disclosure and Transparency rules) Instrument 2006, 5.1.2. See: [https://www.handbook.fca.org.uk/instrument/2006/2006\\_70.pdf](https://www.handbook.fca.org.uk/instrument/2006/2006_70.pdf)

company but may have voting or other rights that allow them to exercise control, such as appointing or removing the majority of directors;

- e. the information to be disclosed about individuals includes at least the name, date of birth, nationality, contact address, how the individual's beneficial ownership is exercised and the level of ownership or control;
- f. clarity about any exemptions – perhaps for listed companies and wholly government owned entities;
- g. a threshold for reporting individual beneficial owners and PEPs; and
- h. PEPs must be disclosed and are generally subject to a more rigorous regime than other beneficial owners.

3.4. While there is general agreement on key elements of a beneficial ownership definition comparator countries (Australia, Indonesia, the Kyrgyz Republic, Mongolia, the United Kingdom, Ukraine and Zambia) and organizations/initiatives (EITI, EU and FATF) have adopted different approaches to some aspects of these key elements, as summarized in the Table 1 below.

**Table 1: Summary of Beneficial Ownership Definitions (including PEPs) for Comparator Countries, Organizations and Initiatives in Comparison with Azerbaijan's Definitions (Existing Law and proposed for Extractive Industries)**

Comparator Countries and International Institutions/ Initiatives		Natural Person	Ownership & Control	Direct & Indirect Ownership	General Threshold (%)	Stock Exchange Exemption	Government Exemption	PEPs
Australia		✓	✓	✓	25	x	x	✓
Indonesia		✓	✓	✓	25	x	x	x
Kyrgyz Republic	EITI	✓	✓	✓	5	x	x	✓
	Law	✓	✓	✓	10	x	x	✓
Mongolia (draft law)		✓	✓	✓	20	x	x	✓
UK		✓	✓	✓	25	✓	x	✓ <sup>a</sup>
Ukraine		✓	✓	✓	25	x	x	✓ <sup>b</sup>
Zambia	EITI	✓	✓	✓	None	x	x	✓
	Law	✓	✓	✓	25	x	x	x
EITI		✓	✓	✓	5-25	✓	x	✓
EU		✓	✓	✓	25	✓	x	✓
FATF		✓	✓	✓	25	x	x	✓
Azerbaijan	Existing Law	x	✓	✓	x	x	x	✓
	Proposed	✓	✓	✓	20	x <sup>c</sup>	✓	✓

<sup>a</sup> Although it is contained in separate legislation.

<sup>b</sup> Similar to the UK.

<sup>c</sup> Introduction of stock exchange exemption to be considered in 3-5 years after RBOD implementation. See paragraph 5.17 for further discussion of the point.

Source: Consultants' research; see Report II for further detail.



- 3.5. From this chart it can be seen that there is complete consensus on the first three components of a beneficial ownership definition among all comparator countries, organizations and initiatives (i.e. the need for the beneficial owner to be a natural person; the need for the definition to capture natural persons whether they have legal ownership or have actual control; and regardless of whether they have direct or indirect ownership or control). While Azerbaijan's existing beneficial ownership definition allows a beneficial owner to be either a "natural person" or a legal entity, for the reasons explained further on in this report, the proposed definition for the extractive industries in Azerbaijan will include the requirement that the beneficial owner must (in all but one case) be a "natural person" in line with international good practice.
- 3.6. There is no complete consensus amongst the comparator countries on how to deal with PEPs, and the approach varies from the absence of any enhanced reporting requirements for PEPs (in the case of Zambia and Indonesia), to a proposal from Global Witness that any interest held by PEPs, however small, should be disclosed. It is however generally accepted that an enhanced disclosure regime should apply for PEPs. PEPs are included in Azerbaijan's existing beneficial ownership definition, albeit applicable to foreign PEPs only. For the reasons explained later in this report, the proposed definition for the extractive industries will likewise include both foreign and local PEPs in line with international good practice.
- 3.7. However, comparator countries and organizations/initiatives have taken a substantially different approach in relation to the threshold level that triggers the beneficial ownership reporting regime – ranging from 5% to 25%. Clearly a lower threshold will increase transparency but must be balanced against the additional administrative burden for both the private sector and the governmental agency tasked with administering and enforcing the legislation. While Azerbaijan's existing beneficial ownership definition does not specify any ownership or control thresholds, for the reasons explained further on in this report, the proposed definition for the extractive industries will include the following thresholds: 5% (PEPs) and 20% (natural persons). This 20% threshold to trigger mandatory disclosure has been chosen for the following reasons: (i) under the International Financial Reporting Standards<sup>33</sup> used by businesses in Azerbaijan for accounting purposes a company is deemed to have a "significant influence" in another company if it holds a 20% or greater interest; and (ii) Article 68 of Azerbaijan's Civil Code classifies an enterprise as "dependent" on another enterprise where more than 20% of the charter capital of a limited liability company or more than 20% of voting shares of a joint stock company belong to another (dominant, participating) partnership or company.
- 3.8. Similarly, despite a recent EITI recommendation few of the comparator countries considered in Report II have implemented specific exemptions for companies listed on recognized stock exchanges or that are government

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<sup>33</sup> <https://www.ifrs.org/issued-standards/list-of-standards/ias-28-investments-in-associates-and-joint-ventures/>

owned or controlled.<sup>34</sup> Both of these approaches may reduce the administrative burden to some degree, while likely to increase complexity at the same time. The balance of these will be a function of local factors. It remains to be seen how widely they are adopted going forward, but for the moment the Consultants do not propose introducing a listed company exemption, while recommending that the situation be revisited after 3-5 years (See paragraph 5.14 et seq. for further discussion).

- 3.9. This Report III addresses each of the above key constituent elements, summarizes the relevant existing Azerbaijani legislation and its compliance with international good practice (see Chapter 4), identifies the options available (see Chapter 5 and Appendix 1), and in the process of producing a proposed definition of “beneficial owner” then recommends: (i) a draft core definition of “beneficial owner” (See Chapter 6); and (ii) the preferred option leading to the legislative adoption of the proposed definition.
- 3.10. Table 1 included in paragraph 3.3 above shows that Azerbaijani Law already contains a beneficial ownership definition, first introduced in the AML Law. This definition has now also been included into other financial service laws which were amended so that the previous references to “beneficiary” were replaced by the term “beneficial owner”. The next Chapter of this report considers the extent to which the existing Azerbaijani definition of beneficial owner complies with good practice, and whether changes are needed.

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<sup>34</sup> The apparent low rate of adoption of the Listed Company exception by comparator countries in Report II may result from the fact that the recommendation is recent, and most regimes are still developing. However, the 28 EU Member States and 51 EITI countries (acknowledging that there is some crossover), have an exemption in their requirements/guidance. Therefore, most countries are yet to fully adopt them. A further factor could be where implementing country’s own stock exchange would not be a suitable “recognized stock exchange” either because its regulation is not yet sufficiently developed to require appropriate disclosure, or because the culture of compliance is still developing, or because the majority of companies entitled to take the benefit of such an exception will not be incorporated or headquartered in the implementing country.

## 4. Review of Relevant Existing Azerbaijani Legislation and its Compliance with International Good Practice

4.1. This Chapter addresses the current definition of “beneficial ownership” as set out in Azerbaijani law and the impact of the Azerbaijani Constitution and legislation on the concept of a mandatory beneficial ownership disclosure regime.

### a. Definition of “Beneficial Ownership” in Azerbaijani Law

4.2. Azerbaijani law already contains a beneficial ownership definition, first introduced in the AML Law (see Appendix 2). This definition has now also been included into other financial service laws<sup>35</sup> which were amended so that the previous reference to “beneficiary” were replaced by the term “beneficial owner”.

4.3. The current Azerbaijani definition can be translated into English as follows:

*“Beneficial owner – natural person or legal entity who ultimately derives economic or any other benefit from operations with monetary means or other property, including the actual owner of the legal entity benefiting from the transaction or a natural person who controls a customer and/or the natural person on whose behalf a financial transaction is being conducted or a natural person who controls a legal entity.”*

4.4. The existing Azerbaijani definition is heavily based on the FATF recommendation, as would be expected in laws that are fundamentally concerned with regulation of financial and related services. Whilst the definition contains many useful elements it is not entirely appropriate for use in the extractive industries sector where the focus is more broadly on corrupt practices through the undue exercise of control and influence rather than FATF’s key focus areas of anti-money laundering and terrorist financing.

4.5. In particular the Azerbaijani definition fails to address the following issues required by international good practice in the extractive sector:

- a. it permits a legal entity to be treated as the ultimate beneficial owner;
- b. it only refers to foreign PEPs; and
- c. there is no specific threshold for reporting individual beneficial owners, whether PEPs or otherwise.

The existing Azerbaijani “beneficial owner” definition is, therefore, inadequate for adoption for the extractive industries’ RBOD implementation purposes.

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<sup>35</sup> The Law on Investment Funds and the Law on the Securities Market (see Bibliography for details).

## b. Definition of “Politically Exposed Person” In Azerbaijani Law

- 4.6. Azerbaijani law also already contains a definition relating to politically exposed persons (“PEP’s”) in the AML Law, but subject to the limitation that it only relates to PEPs of a foreign country:

*<sup>36</sup>Politically exposed persons of a foreign country – individuals who are or have been entrusted with prominent public functions in a foreign country (Heads of State or of government, senior politicians, senior government, judicial or military officials, senior executives of state-owned corporations, important political party officials), as well as their family members or close associates.*

- 4.7. Whilst this is similar to the AMLD4 definition<sup>37</sup> it is less precise, there is no specific threshold for reporting PEPs, it relates solely to PEPs of a foreign country and additionally does not define key concepts such as family members and close associates. The Consultants have, therefore, recommended a revised PEP definition as specified in Chapter 5 below.

## c. The Impact of the Azerbaijani Constitution and Other Relevant Laws

- 4.8. There are other pieces of Azerbaijani Law that may have an impact on the introduction of a mandatory beneficial owner disclosure regime. Although these will be considered in detail in later reports they are flagged here as part of the consultants’ necessary legal due diligence.

### **The Constitution of the Republic of Azerbaijan<sup>38</sup>**

- 4.9. The Constitution of the Republic of Azerbaijan of 1995 does not contain any specific provisions that would prevent beneficial ownership disclosure in the extractive industries although it does set out basic principles that are relevant - such as Article 14 of the Constitution which clearly states that:

*“Without prejudice to rights and interests of any physical persons and legal entities natural resources belong to the Republic of Azerbaijan”,*

thus, underlining the importance of beneficial ownership disclosure as a tool to enforce one of the principles of the Constitution.

- 4.10. The Constitution also recognizes the right of personal security in Article 32, which is taken to include the right of personal data secrecy, which may also be relevant if there was a requirement to disclose personal details such as

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<sup>36</sup> AML Law 1.0.14.

<sup>37</sup> See: <https://publications.europa.eu/en/publication-detail/-/publication/c5e737f2-597f-4d54-8089-52903c1e4f0f/language-en>

<sup>38</sup> <http://www.constcourt.gov.az/laws/26>

residential address in circumstances where it might expose the individual to harm. This will be considered in more depth in later reports when discussing the extent of disclosure of information in the proposed beneficial ownership disclosure regime for Azerbaijan's extractive industries.

#### **Law on Energy of 1998<sup>39</sup> and Law on Subsoil of 1998<sup>40</sup>**

- 4.11. The Consultants anticipate that the following 1998 laws may also require amending to permit and implement any beneficial ownership disclosure regime:
- a. Law on Energy sets out general provisions regulating the activities in the energy sector, including oil and gas exploration and production; and
  - b. Law on Subsoil sets out provisions regulating exploration and exploitation of natural subsoil reserves including but not limited to oil and gas as well as relations between private entities and the state in this area.
- 4.12. Due to the wide application in Azerbaijan of PSAs which have the force of law and which are specifically "ring-fenced" against any potential contradictory legislation or regulation, the Law on Subsoil and the Law on Energy have had less impact than might have been expected on the oil and gas industry.
- 4.13. Notwithstanding the limited application of these laws, both the concept of beneficial ownership and the mechanism and extent of disclosure will however need to be introduced into these laws if a stand-alone law is not to be used. While recognizing the specific legal nature of PSAs in specific areas they do allow disclosure of information (including confidential information) in accordance with requirements of applicable laws.<sup>41</sup>

#### **Law on State Registration and the State Register of Legal Entities of 2004<sup>42</sup>**

- 4.14. The Law on State Registration and the State Register of Legal Entities sets out rules on state registration of commercial and non-commercial legal entities in Azerbaijan as well as branches and representative offices of foreign legal entities and rules on maintenance of the state register of legal entities. The Law has been in force since 2004 and has been subject to numerous amendments having the purpose of simplification of the process on registration of commercial legal entities.

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<sup>39</sup> <http://e-qanun.az/framework/5095>

<sup>40</sup> <http://e-qanun.az/framework/4273>

<sup>41</sup> Please see e.g. Article 27.1(a)(3) of ACG PSA. Whilst PSA's are grandfathered and supersede any conflicting laws, they have no impact on the subject of a local law if it is not addressed in the PSA. [https://www.bp.com/content/dam/bp-country/en\\_az/pdf/legalagreements/PSAs/ACG\\_PSA.pdf](https://www.bp.com/content/dam/bp-country/en_az/pdf/legalagreements/PSAs/ACG_PSA.pdf)

<sup>42</sup> <http://e-qanun.az/framework/5403>

This law will need to be amended to ensure that details of beneficial ownership in the extractive industry are publicly available and to provide an implementing mechanism.

#### **Law on Commercial Secrets of 2001<sup>43</sup>**

- 4.15. The Law on Commercial Secrets of 2001 defines what information is considered a commercial secret and sets out the legal regime of such information. At present the law considers information on immediate owners of commercial companies (let alone ultimate beneficial ownership) a commercial secret. The law will need to be amended to ensure that information on ownership and beneficial ownership of extractive companies does not constitute a commercial secret.

#### **Tax Code of 2000<sup>44</sup>**

- 4.16. The Tax Code of 2000 is the primary and exclusive legal act setting out tax rates, tax reporting requirements, authorities of tax bodies and other tax matters. As the corporate register of commercial legal entities is managed by the tax authority the Tax Code contains certain provisions on commercial secrecy of information recorded in the corporate register. These provisions should be reviewed to achieve the required beneficial ownership disclosure regime.

#### **Law on Personal Data of 2010<sup>45</sup>**

- 4.17. The Law on Personal Data of 2010 prescribes provisions restricting disclosure and dissemination of personal data. Once the mechanism for beneficial disclosure is defined there may be a need to amend the law to ensure that disclosure of certain information on individual beneficial owners is legal.

#### **Law on the Prevention of the Legalization of Criminally Obtained Funds or Other Property and the Financing of Terrorism of 2009<sup>46</sup>**

- 4.18. This AML Law was enacted in 2009 and contains the definition of beneficial owner. Changes to this law may be required to ensure that beneficial ownership in the extractive industry is properly defined and there is no terminological contradiction.

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<sup>43</sup> <http://www.taxes.gov.az/modul.php?name=qanun&news=67>

<sup>44</sup> [http://www.taxes.gov.az/modul.php?name=qanun&cat=3&lang=\\_eng](http://www.taxes.gov.az/modul.php?name=qanun&cat=3&lang=_eng)

<sup>45</sup> <http://e-qanun.az/framework/19675> [No reliable English translation online]

<sup>46</sup> <http://www.fiu.az/eng/wp-content/uploads/2014/10/AML-CFT-law-1.pdf>

## 5. Options and Recommendations Relating to the Constituent Elements of a Mandatory Beneficial Ownership Regime

- 5.1. Chapter 3 summarizes the key elements of a beneficial ownership definition considered in detail in Report II and Chapter 4 of this report compares the current Azerbaijani definitions with international good practice. This Chapter 5 identifies each of the key elements, the options relating to each key element and gives a reasoned recommendation in respect of each element.
- 5.2. Appendix 1 to this report sets out a summary of the key elements of a mandatory beneficial ownership disclosure regime, together with the alternatives addressed in this Chapter 5.

### The Need for a “Natural Person”

- 5.3. Various multilateral institutions and initiatives have provided guidance or draft definitions setting out what they believe should be addressed in the core definition of a beneficial owner. All definitions generally require the beneficial owner to be a “natural person” rather than a corporate or legal entity:<sup>47</sup>
  - a. the 2014 FATF Recommendation states that:

*“Beneficial owner refers to the natural person(s) who ultimately owns or controls a customer and/or the natural person on whose behalf a transaction is being conducted. It also includes those persons who exercise ultimate effective control over a legal person or arrangement.”*
  - b. the 2014 G20 High Level Principles on Beneficial Ownership Transparency include the following statement:

*“Countries should have a definition of ‘beneficial owner’ that captures the natural person(s) who ultimately owns or controls the legal person or legal arrangement.”*
  - c. the EU 2015 4th Anti-Money Laundering Directive (AMLD4) defines a “beneficial owner” of a company as:

*“natural person(s) who ultimately owns or controls a legal entity through direct or indirect ownership of a sufficient percentage of the shares or voting rights or ownership interest in that entity.”*
  - d. in case of the 2016 EITI Standard 2.5, a beneficial owner is defined as follows:

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<sup>47</sup> Note that a legal entity may not just include companies – but may include additional forms of entity that are treated as being separate legal personality under their jurisdiction of incorporation (eg cooperatives under the Laws of Australia). For the purposes of this report we use the term “legal entity” in this wider context.

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

- 5.4. EITI Requirement 2.5 and subsequent EITI guidance largely reflect the prior developed definitions of FATF and EU and, therefore, can be considered highly influential in identifying international good practice in relation to beneficial ownership disclosure. It also has the additional benefit of having been tailored to the specific needs of the extractive industries, rather than money laundering, funding of terrorism, or other financial regulatory issues.

## **Recommendation**

- 5.5. Given the high degree of consensus, the Consultants recommend that, subject to consideration of two possible exceptions (in relation to listed companies and government owned or controlled companies) discussed in paragraphs 5.14 - 5.16 below, a beneficial owner must be a “natural person”. This recommendation that a beneficial owner must be a “natural person” is in line with the approach taken by all comparator countries.

## **Alternative**

- 5.6. The Consultants offer no alternative for the core definition as the overwhelming weight of advice from international organizations and from already adopted definitions show a high degree of consistency. Acceptance of a definition that is not clear on this point would undermine the purpose of this RBOD implementation initiative for Azerbaijan’s extractive industries.

## **The Issue of Ownership and Control - Both Direct and Indirect**

- 5.7. All institutional and national definitions reviewed for this report refer to a beneficial owner not just as someone who owns a legal entity, but also include references to someone who **controls** a legal entity, recognizing that there are legal structures (e.g., share warrants [see footnote 12], bearer shares [see footnote 13], nominee shareholdings [see footnote 14], trust and trust like arrangements<sup>48</sup>, patronage<sup>49</sup>, etc.) that give rise to effective control or influence, even without legal ownership. This is an important aspect of beneficial ownership disclosure as it allows disclosure of individuals who can direct where the financial benefits are destined and prevents them from hiding behind trusts, nominee directors, etc. “Control” is typically expressed in beneficial ownership definitions in terms of voting rights and/or the ability to appoint and remove the majority of directors. The expression of control in terms of voting rights reflects structures where the percentage of shares held is not in proportion to voting rights (e.g. a shareholder may own a minority of shares but enjoy a majority of votes due to holding preference shares), whilst control may also be exerted in less direct ways.

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<sup>48</sup> Trust and trust like arrangements are arrangements by which the legal owner of an interest actually holds the interest on behalf of another person (the beneficiary).

<sup>49</sup> Patronage is the ability to exert influence through the ability to control appointments, the distribution of privileges or economic benefit.



- 5.8. Another common component to the beneficial ownership definitions is the reference to both **direct** and **indirect** ownership and control. This is a key aspect of beneficial ownership as it distinguishes beneficial ownership from legal ownership. This aspect reflects the reality that there is often a chain of ownership or control of a legal entity or a legally binding arrangement that may consist of a series of companies, trusts and individuals. The data provided in Mongolia's 2016 EITI report highlights this aspect, as the owners listed are a mixture of companies and individuals. The reference to **indirect ownership** or **control** compels the disclosure of the real individuals at the top of the ownership chain regardless of whether they are also the legal owners. This reference to indirect ownership or control avoids disclosure of direct legal ownership or control only, which may be used as a "firewall" to protect the identity of the real beneficial owners.

## Recommendation

- 5.9. EITI has advised that provisions used in beneficial ownership legislation must be "clear and leave no room for discretionary interpretation...[to] minimize the risk of circumvention". In this context, failure to expressly include **direct or indirect ownership and control**, or to explain further what they mean in this context would leave matters open to subjective interpretation. The Consultants therefore recommend to expressly include references to a beneficial owner being the natural person who has direct or indirect ownership or control in a legal entity in the core definition of a "beneficial owner". This recommendation is in line with the other comparator countries approach to the issue.
- 5.10. Based on the recommendations made in paragraphs 5.5 and 5.9 above, the Consultants further recommend the following as the core definition of a "beneficial owner" that expressly addresses the three key elements (that the beneficial owner must be a natural person or persons, that own(s) or control(s) the legal entity; and that ownership and control may be direct or indirect) and that additionally extends the concept beyond incorporated entities to binding legal arrangements as well:

***"Beneficial Owner:***

- a) A "beneficial owner" of a legal entity or legally binding arrangement is the natural person who ultimately owns or controls the legal entity or legally binding arrangement, whether such ownership or control is direct or indirect.***
- b) For the purposes of a), if a natural person directly or indirectly:***
  - i) owns or controls [x%] or more of the shares or voting rights in the legal entity or legal arrangement;***

- ii) has the right to appoint, veto the appointment or remove a majority of the board of directors or equivalent body of a legal entity or legally binding arrangement; or**
- iii) in circumstances where i) and ii) do not apply, has the right to exercise, or actually exercises significant influence or control over or derives significant economic benefit from,**
  - a. the legal entity or legally binding arrangement; or**
  - b. a trust or firm which is not a legal entity but would itself satisfy any of criteria i) to ii) if it were;**

**then that natural person shall be deemed to “own or control” a legal entity or legally binding arrangement.**
- iv) For the avoidance of doubt agents, nominees, trustees and other intermediaries shall not be deemed to be the “beneficial owner”.**
- v) In the case of joint ventures, each entity within the venture should disclose its beneficial owner(s).<sup>50</sup>**

## **Alternative**

- 5.11. The Consultants offer no alternative to the inclusion of direct and indirect ownership or control in the core definition of beneficial ownership as the overwhelming weight of advice from international organizations and from already adopted definitions again show a high degree of consistency.
- 5.12. Whilst it would be possible to leave the concept of “own or control” unclarified and a matter for national courts to address, this is not recommended as the uncertainty could lead to subjective approaches, inconsistent court rulings and less reliable reporting. The Consultants have therefore proposed a definition of the concepts of ownership or control, similar to that adopted in the UK where it has operated successfully, but have additionally included a reference to binding legal arrangements. It is recognized that this additional reference could be removed.
- 5.13. It is acknowledged that the use of the word “significant” in iii) of the above definition introduces a subjective concept. The use of the word “significant” is however similar to the word “substantial” used in relevant United States legislation and cited approvingly by both the Natural Resources Governance Institute and Global Witness.<sup>51</sup>

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<sup>50</sup> See EITI Standard 2.5 f) iv.

<sup>51</sup> See page 12, Global Witness “Assessment of EITI Beneficial Ownership Pilots” (March 2015).

## Possible Exceptions to the Rule that a Beneficial Owner must be a “Natural Person”

- 5.14. Although there is wide acceptance that a beneficial owner should generally be a natural person, there is also limited recognition that there are two other classes of beneficial owners who are not natural persons, i.e. listed companies and governments.
- 5.15. **Listed Companies:** EITI Requirement 2.5 and relevant definitions reviewed recognize that tracing ownership back to a company admitted to trading on a recognized stock exchange (a “Listed Company”) is sufficient to establish beneficial ownership – both the EITI definition and the UK and EU legislation allow an exemption for Listed Companies on the condition that they are listed on one of the stock exchanges stated in their respective legislations. The restriction to a list of “recognized stock exchanges” (in the words of the UK regulations) is to ensure that any exemption for listed companies is granted only to companies that are already subject to stringent governance and transparency regimes that require the publicly available identification of a natural person under the rules of the recognized stock exchange in appropriate circumstances.<sup>52</sup> As a matter of process it would be for the company wishing to apply for such an exemption to demonstrate that it satisfies the criteria and if the application was accepted by the beneficial ownership registry this information would be recorded and be publicly available.
- 5.16. **Government-Owned Companies:** There is a tendency towards recognizing that a government can also be listed as a beneficial owner although none of the definitions reviewed explicitly grant an exemption to government-owned companies. Whilst the EITI definition does not give “government” as a possible beneficial owner, advice from the EITI International Secretariat to implementing countries encourages them to accept their respective governments as a beneficial owner and EITI reports include examples of beneficial ownership traced back to government-owned entities.

## Recommendation

- 5.17. The Consultants acknowledge that requiring Listed Companies that are already subject to satisfactory rules about disclosure of beneficial ownership, to provide information that is already publicly available provides little additional transparency. However, as beneficial ownership disclosure in the extractive sector is relatively uncharted territory in Azerbaijan the Consultants recommend that a Listed Company exception is not included initially but is considered after 3 - 5 years. If at that point there is evidence

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<sup>52</sup> In the case of a Premium Listed company the UK listing Rules require ownership disclosure once a threshold of 3% is crossed - Disclosure and Transparency Rules, Rule 5.1.2 [https://www.handbook.fca.org.uk/instrument/2006/2006\\_70.pdf](https://www.handbook.fca.org.uk/instrument/2006/2006_70.pdf)

that the absence of such exemption has caused any problems, the situation can be addressed then.<sup>53</sup>

- 5.18. Although not applied by any of the comparator countries, the Consultants accept that government- owned or -controlled entities cannot be considered to have a “natural person” as a beneficial owner and recommend that this is addressed now to avoid an obvious source of confusion.
- 5.19. Based on the recommendations made in paragraphs 5.17 and 5.18 above, the Consultants therefore suggest that the core definition set out in paragraph 5.10 is modified by the following addition:

***If a government or governmental body would, if it were a natural person, be deemed to be a beneficial owner pursuant to clause [X] above then that government or governmental body shall be a beneficial owner.***<sup>54</sup>

- 5.20. The recommendation relating to Listed Companies reflects the approach adopted by the majority of the comparator countries, although a different approach has been taken by the UK, EU and is recommended by EITI.
- 5.21. The recommendation relating to government owned or controlled companies reflects the situation recommended by EITI, albeit that such approach has not yet been adopted in any comparator countries beneficial ownership definitions. Given that this is a relatively recent development, Consultants will monitor relevant developments on the likely approach to be taken by comparator countries, organizations and initiatives and provide an update during the stakeholder consultation event planned in Baku in February 2019.

## **Alternatives**

- 5.22. The Consultants recognize that it would be possible to allow companies to trace ownership back only as far as a company admitted to trading on a recognized stock exchange and that this might marginally decrease the administrative burden for Listed Companies.

## **How to deal with Politically Exposed Persons?**

- 5.23. The undisclosed beneficial ownership of PEPs in the extractive industries has historically caused much concern.<sup>55</sup> Disclosure of PEPs is an essential part of beneficial ownership disclosure in the extractive sector and both

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<sup>53</sup> If there is a decision to adopt a Listed company exception the Consultants propose adopting a list of “recognized stock markets” similar to those of the UK and EU. In the UK this includes Israeli, Japanese, European Economic Area, Swiss and US markets. For a full list: [https://www.stevens-bolton.com/cms/document/The\\_UK\\_PSC\\_Register\\_Requirements\\_.pdf](https://www.stevens-bolton.com/cms/document/The_UK_PSC_Register_Requirements_.pdf)

<sup>54</sup> It is important to recognize however that there may be more than one party that qualifies as a beneficial owner of an entity - and that it is possible for a government entity to be listed as a beneficial owner, as well as one or more qualifying natural persons. The use of the word “a” rather than “the” in this definition ensures that this is recognized.

<sup>55</sup> See e.g.: <https://www.nytimes.com/2017/12/20/business/energy-environment/shell-eni-italy-nigeria.html>

industry and civil society encourage the inclusion of PEPs as it adds to transparency, avoids undisclosed conflicts of interests by key decision makers and builds confidence in the integrity of the sector. Failure to do so is often seen as an indicator of poor governance, an inefficient regulatory system and latent corruption. Lack of clarity in this area can result in a loss of investor and financier confidence and civil disquiet when information enters the public domain in an unstructured manner.

- 5.24. The inclusion of provisions on PEPs is recommended by the EITI and is addressed expressly in the vast majority of institutional and most of the comparator countries beneficial ownership definitions.
- 5.25. Almost all definitions reviewed for this report contain reference to PEPs with a threshold that is lower than for other types of beneficial owners,<sup>56</sup> in light of the additional influence that PEPs may be able to bring to bear. This threshold for PEPs is addressed later in this report.
- 5.26. So far as the types of persons who should be treated as PEPs is concerned the EU has set out a detailed definition of “politically exposed person” in the Fourth Money Laundering Directive which captures good practice in this area and addresses issues such as interests held by family members or related parties and provides clarity as to exactly who a PEP is.

## **Recommendation**

- 5.27. The Consultants recommend that Azerbaijan adopts a modified version of the AML 4 definition setting out the types of persons that should be treated as a “politically exposed person” as it is simple and has proved effective and clear:

***“The term ‘politically exposed person’ means a natural person who is or who has been entrusted with prominent public functions and includes but is not limited to the following, and their family members and persons known to be their close associates:***

***(a) heads of State, heads of government, ministers and deputy or assistant ministers;***

***(b) members of parliament or of similar legislative bodies;***

***(c) members of the governing bodies of political parties;***

***(d) members of supreme courts, of constitutional courts or of other high-level judicial bodies, the decisions of which are not subject to further appeal, except in exceptional circumstances;***

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<sup>56</sup> Typically, in the range 1-5%, in line with EITI guidance. See paras 5.32 and 5.35.

**(e) members of courts of auditors or of the boards of central banks;**

**(f) ambassadors, chargés d'affaires and high-ranking officers in the armed forces;**

**(g) members of the administrative, management or supervisory bodies of State-owned enterprises;**

**(h) directors, deputy directors and members of the board or equivalent function of an international organisation.**

**No public function referred to in points (a) to (h) shall be understood as covering middle-ranking or more junior officials**

**'family members'<sup>57</sup> includes the following:**

**(a) the spouse, or a person considered to be equivalent to a spouse, of a politically exposed person;**

**(b) the children or grandchildren and their spouses, or persons considered to be equivalent to a spouse, of a politically exposed person;**

**(c) the parents or grandparents of a politically exposed person;**

**whether such relationship be natural, adoptive or otherwise.**

**'persons known to be close associates' means:**

**(a) natural persons who have joint beneficial ownership of legal entities or legal arrangements, or any other close business relations, with a politically exposed person;**

**(b) natural persons who have sole beneficial ownership of a legal entity or legal arrangement which is known to have been set up for the de facto benefit of a politically exposed person. "**

## **Alternatives**

5.28. Whilst it would be possible to reduce or delete the explanatory list entirely to do so would lead to increased subjective interpretation of the legislation.

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<sup>57</sup> The AMLD4 definition has been amended by inclusion of references to grandchildren, grandparents, siblings, etc to ensure it reflects the current provisions of Azerbaijani Law.

## What Level of Ownership Should Trigger Disclosure of Beneficial Ownership?

- 5.29. The threshold for reporting ownership or control varies across definitions and is generally different depending on whether the natural person is a PEP or not. However, there is general recognition that a threshold is an essential element of a beneficial ownership definition.
- 5.30. Whilst FATF and the EU suggest that the threshold for reporting beneficial ownership should be 25%,<sup>58</sup> the EITI gives implementing countries flexibility in setting a threshold, suggesting a range of 5-25%. While Zambia originally set no threshold, it is currently set at 25%; the Kyrgyz Republic set 5%, but it is now 10% and both UK and Ukraine set 25%. The current Azerbaijani legislation does not include a threshold level and so is effectively zero.
- 5.31. Similarly, the level of precision in reporting the ownership level also varies. A common practice in EITI implementing countries is for the precise level of ownership to be disclosed where that level exceeds the threshold. The UK however takes a different approach requiring disclosure of ownership or control within three bands. This makes the extent of ownership less clear and it is not always possible to tell the precise level of ownership.
- 5.32. Almost all the definitions reviewed for this report contain reference to PEPs with a threshold that is lower than for other classes of beneficial owners (in the light of the additional influence that PEP's may be able to bring to bear). A notable exception is the UK where there is already a robust process in place for politicians and senior officials to disclose their business interests. Failure to address PEPs (as is, for example, in the case of Zambia's legislation) is a significant weakness, as is any ambiguity in this area.

### Recommendation

- 5.33. The Consultants recommend that Azerbaijan adopts a threshold that is realistic and reflects other regional initiatives. The Consultants suggest that this level is 20% for beneficial owners who are not PEPs. The Consultants believe that this provides a balance between the need to ensure an appropriate level of transparency and the administrative burden that new regulations would involve, whilst remaining consistent with the stated policy objectives of the Azerbaijani Government.
- 5.34. At this level, the proposed threshold for Azerbaijan would be in towards the high-end of the recommended EITI range (5% - 25%), i.e. higher than that of the Kyrgyz Republic (10%), equal to Mongolia's threshold, but lower than those applied in the EU, UK and other comparator countries (25%).

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<sup>58</sup> Disappointingly the July 2018 FATF report records that less progress has been made in this area than would be desirable, offering a competitive advantage to those countries who are actively engaging with the beneficial ownership agenda. See: <https://www.fatf-gafi.org/media/fatf/documents/reports/FATF-Report-G20-FM-CBG-July-2018.pdf>

- 5.35. The Consultants recommend that Azerbaijan adopts an enhanced PEP regime requiring disclosure of a PEP's beneficial ownership at a level that is lower than that adopted for other beneficial owners. Whilst some NGO's active in this area have suggested that all PEP beneficial ownership should be disclosed, the Consultants recommend that PEP's with an interest of 5%<sup>59</sup> should be subject to the beneficial ownership disclosure regime. This is at the top end of the EITI recommended range and will need to be kept under review.
- 5.36. The Consultants also note that the current Azerbaijani definition of "beneficial owner" contains no specific threshold, but instead relies on more subjective tests of ultimate control and ultimate economic benefit and as a consequence this may result in a more arbitrary interpretation, especially before clear custom and practice has arisen.

## Alternatives

- 5.37. The Consultants recognize that it would be possible to adopt a threshold of between 5% and 25% for beneficial owners who are not PEPs and remain within international good practice. The Consultants believe however that in the Azerbaijani context 20% is an appropriate level. The Consultants accept that the level might be reviewed for appropriateness once the beneficial ownership regime has been implemented for a sufficient period and any lessons learnt, including in relation to this threshold, reflected.
- 5.38. Liberia has introduced provisions so that where no one person reaches the usual threshold then a number of the top shareholders (ranked by interest) are required to disclose their percentage interest. This does however seem to be a complication that may not provide significantly more transparency if the threshold level initially chosen is correct. The Consultants do not recommend its adoption unless there are specific policy issues to be addressed.
- 5.39. The proposed threshold level of 20% is higher than the levels that would be proposed by many CSOs<sup>60</sup> and the threshold should be seen in conjunction with the proposal relating to beneficial ownership disclosure obligations for politically exposed persons where much greater transparency is required and a much lower threshold appropriate.<sup>61</sup>

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<sup>59</sup> Global Witness and the EITI have suggested that there be no threshold and that all PEPs with a beneficial interest should be disclosed. The Consultants have suggested this 5% threshold for mandatory disclosure by PEPs. Whilst there is no developed consensus in this area, it is proposed to set it at the bottom end of the EITI recommended range (5%-25%). Although well above the level typically suggested by some NGOs, the proposed 5% acknowledges the additional issues coinciding with ownership by PEPs (see paragraph 5.23) and reflects the level adopted by some comparator countries (including the Kyrgyz Republic and UK).

<sup>60</sup> Global Witness suggest that 5% or less is appropriate for general disclosure in the extractive industry sector.

<sup>61</sup> See: <https://www.globalwitness.org/en/blog/10-lessons-uks-public-register-real-owners-companies/> which suggest an interest of 5 should be reported.



## To what Legal Entities Should the Beneficial Ownership Regime Apply?

- 5.40. Whilst the FATF and EU beneficial ownership regimes apply to the whole economy and a number of jurisdictions have used the impetus provided by the EITI initiatives to introduce economy wide regimes (e.g. Ukraine, UK, etc.), the EITI Standard 2016 applies only to the extractive industries in implementing countries.
- 5.41. It is proposed that the recommendations contained in this report should be limited to the Azerbaijani extractive industry sector – by which the Consultants mean the mining, upstream (exploration and production) and midstream (bulk processing, bulk storage, bulk marketing or bulk transportation of extractive commodities) sectors. This is within the RBOD implementation mandate of SOFAZ/EITC, while addressing a significant part of the Azerbaijani economy.<sup>62</sup> During initial consultations, the general feeling amongst relevant counterparts interviewed was that the scope of the initiative should not be overly ambitious. Over time, however, GOA may decide to apply the beneficial ownership regime to other sectors of the economy.

### Recommendation

- 5.42. The Consultants recommend that the compulsory beneficial ownership disclosure regime apply to all legal entities that operate within the defined sector, whether they are Azerbaijani or foreign registered. Whilst it would be possible to limit the scope only to Azerbaijani registered companies it would allow for an obvious means of defeating the legislation, especially if the jurisdiction of incorporation itself had no beneficial ownership disclosure regime.
- 5.43. The Consultants recommend that the beneficial ownership regime should apply to any legal entity that holds, or wishes to apply for, mineral extraction rights as well as substantial contractors supporting the sector so that the new regime applies to:
- a. an applicant for, and all existing holders, of any mineral extraction rights;<sup>63</sup>
  - b. an applicant for, and all existing holders, of any rights to provide bulk processing, storage, marketing or transportation of extractive commodities; and

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<sup>62</sup> Roughly 45% of GDP - <https://www.nordeatrade.com/en/explore-new-market/azerbaijan/economical-context>

<sup>63</sup> EITI's recommendations for beneficial ownership are contained in clause 2.5 of the 2016 update of the Standard recommend that implementing countries: "maintain a publicly available beneficial ownership register that includes companies that "bid for, operate or invest in extractive assets".

- c. any existing or prospective contractor or sub-contractor providing services within the extractive sector in Azerbaijan to one or more persons captured by the above two criteria, where such services have or, in the case of contractor or sub-contractor<sup>64</sup> to whom a contract is awarded, will have an aggregated contract value exceeding US\$ 10,000,000.<sup>65</sup>

5.44. The Mongolian and Kyrgyz approach is limited to applicants falling within criterium 5.43.a. above. Taking into account the TORs and given: (i) the substantial sums that may be generated by midstream activities and that may be paid to major contractors; (ii) the financial, technical, health, safety and environmental risks that may result from sub-optimal contracting; (iii) the corrosive impact of a loss of confidence in procurement processes; and (iv) the impact on the national budget and wealth if costs recoverable from the state under PSA terms are unnecessarily inflated, the Consultants also recommend including applicants falling within criterium 5.43.b. and any existing or prospective contractors with the minimum contract value as suggested in criterium 5.43.c. above.

5.45. The Consultants recommend that this information is initially gathered in the following manner:

- a. existing holders of mineral resource<sup>66</sup> extraction rights or of any midstream rights and any existing contractor that falls within the third criteria above should be given 6 months from the date of implementation of the legislation to provide the information to the appropriate registry;
- b. applicants for mineral resource extraction rights or any midstream rights should be required to prove as part of the application process that they have registered this information with the relevant registry;
- c. any existing or prospective contractor or subcontractor falling within the criteria set out above should be required to provide evidence that they have provided the information about beneficial ownership required by law to the relevant registry; and

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<sup>64</sup> In deciding whether a contractor or sub-contractor is providing services to the extractive sector that would merit beneficial ownership disclosure (as described in paragraph 5.41), the State Statistics Committee will be consulted to verify the appropriateness of earmarking the corresponding business activity for such mandatory disclosure. The exact list of relevant business activities will be discussed with the State Statistics Committee during the preparation of the draft beneficial ownership disclosure mechanisms and legislation to ensure proper alignment.

<sup>65</sup> The threshold figure of US\$10million has been selected in the light of the size of costs and investments in the extractive sector, and it is of the same order as the sum set out in Art 13.1(2) of the Antimonopoly Law which sets out the level at which consent is required for merger control purposes. It is intentionally a significant value as the purpose is not to burden small businesses with additional costs and administration but to ensure that material data is captured.

<sup>66</sup> The Subsoil Law differentiates between “mineral resources” and “widespread mineral resources” such as sand and gravel, clay, etc. The use of the term “mineral resources” therefore avoids the inclusion of these lower value activities which may be undertaken by smaller entities.

- d. whilst remedies are not dealt with in detail in this report, failure to do so may constitute mis-procurement and any contractual payments may be treated as non-cost recoverable under a PSA, subject to certain safeguards. Such approach would strongly incentivize the contractor to comply and the principal to ensure that the contractor had complied.

5.46. Whilst outside the scope of this report it is recognized that this information should be:

- a. subject to an updating obligation on the part of the applicant or contractor whenever the earlier reported information changes;<sup>67</sup> and
- b. should be subject to positive confirmation in line with the requirement to confirm other company data lodged with the companies' registry.

## **Alternatives**

5.47. The Consultants recognize that it would be possible to:

- a. alter the scope of application of the beneficial ownership definition – either by limiting it solely to the companies with mineral extraction licenses and/or interests under PSA's (as in the case of the latest proposals from the Kyrgyz Republic and Mongolia). For the reasons given above, however, the Consultants do not recommend reducing the scope to the extent proposed in the respective draft legislation currently considered by the Kyrgyz Republic and Mongolia;
- b. expand the scope by applying the newly proposed beneficial ownership disclosure regime to the entire Azerbaijani economy (as was done in e.g. the UK, Zambia and the Ukraine). Besides this going beyond the current mandate of SOFAZ/EITC, it may also be overly ambitious at this point. Perhaps, this should only be considered once the proposed beneficial ownership disclosure regime has demonstrated its value for the extractive sector. At that time, this may merit potential replication for, or inclusion of, other sectors of the economy; and
- c. alter the proposed maximum contract value criteria specified in subparagraph 5.43.c above.

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<sup>67</sup> Under the existing Companies Law Azerbaijani companies as well as any branches and representative offices are already required to register certain details and notify of any changes, so the concept would not be alien.

## 6. Proposed Beneficial Ownership Definition

- 6.1. Considering the matters referred to above, the Consultants recommend the following as a definition of “beneficial owner” for use in Azerbaijan’s extractive sector, as explained in paragraph 5.40 – 5.44 above.

### 1. Beneficial Owner

A “beneficial owner” of a legal entity or legally binding arrangement is the natural person(s) who ultimately own(s) or control(s) the legal entity or legal arrangement, whether such ownership or control is direct or indirect.

For the purposes of this Clause, if a natural person directly or indirectly:

- a) owns or controls 20% or more of the shares or voting rights in a legal entity; or
- b) in the case where the natural person is a Politically Exposed Person, that natural person owns or controls 5% or more of the shares or voting rights in a legal entity; or
- c) has the right to appoint, veto the appointment or remove a majority of the board of directors or equivalent body of a legal entity or legally binding arrangement; or
- d) in circumstances where a) - c) do not apply, has the right to exercise, or actually exercises, significant influence or control over or derives significant economic benefit from,
  - a. a legal entity or legally binding arrangement; or
  - b. a trust or firm which is not a legal entity but would itself satisfy any of criteria a) to c) if it were;

then that natural person shall be deemed to “own or control” the legal entity or legally binding arrangement.

- e) For the avoidance of doubt agents, nominees, trustees and other intermediaries shall not be deemed to be a beneficial owner.
- f) In the case of a joint venture, each entity within the venture should disclose its beneficial owner(s).

### 2. Exceptions to the “natural person” requirement:

If a government or governmental body would, if it were a natural person, be deemed to be a beneficial owner pursuant to clause 1 above then that government or governmental body shall be a beneficial owner.

### 3. Politically Exposed Persons:

- a) The term 'politically exposed person' means a natural person who is or who has been entrusted with prominent public functions and includes but is not limited to the following, and their family members and persons known to be their close associates:
- a. heads of State, heads of government, ministers and deputy or assistant ministers;
  - b. members of parliament or of similar legislative bodies;
  - c. members of the governing bodies of political parties;
  - d. members of supreme courts, of constitutional courts or of other high-level judicial bodies, the decisions of which are not subject to further appeal, except in exceptional circumstances;
  - e. members of courts of auditors or of the boards of central banks;
  - f. ambassadors, chargés d'affaires and high-ranking officers in the armed forces;
  - g. members of the administrative, management or supervisory bodies of State-owned enterprises;
  - h. directors, deputy directors and members of the board or equivalent function of an international organization.

No public function referred to in points (a) to (h) shall be understood as covering middle- ranking or more junior officials

- b) For the purpose of this clause 3:

'family members' includes the following:

- the spouse, or a person considered to be equivalent to a spouse, of a politically exposed person;
- the siblings, children, grandchildren and their spouses, or persons considered to be equivalent to a spouse, of a politically exposed person, whether such relationship be natural, adoptive or otherwise;
- the parents and grandparents of a politically exposed person;

'persons known to be close associates' means:

- natural persons who have joint beneficial ownership of legal entities or legal arrangements, or any other close business relations, with a politically exposed person;
- natural persons who have sole beneficial ownership of a legal entity or legal arrangement which is known to have been set up for the de facto benefit of a politically exposed person.

## 7. Look Ahead – Other Matters That Will Need Considering in Later Stages

- 7.1. Whilst the focus of this report is the proposed beneficial ownership definition the Consultants flag some consequential issues that will need to be further addressed in future reports.

### Method of Implementation into Law

- 7.2. To be effective the beneficial ownership disclosure regime must obviously be legally binding.<sup>68</sup> Some countries have introduced stand-alone laws to implement beneficial ownership disclosure, e.g. Ukraine, while others have amended existing laws. Both Zambia and the UK used amendments to existing company laws to introduce beneficial ownership requirements whilst the Kyrgyz Republic has amended its Law on Subsoil Use.
- 7.3. In the case of the UK (which added its register to the existing corporate register) the amendment of existing laws appears to have been a vital element in its success as companies were already accustomed to reporting and the existing corporate register was already comprehensive. On the other hand, the standalone approach taken by Ukraine appears to have been less successful as the register has struggled to ensure all companies are captured and currently records about 70% of companies. Both approaches may have been heavily influenced by other cultural factors and the issue will be dealt with further in Report VI.
- 7.4. In order to implement the beneficial ownership disclosure requirements into Azerbaijani law both approaches are possible. Given that introduction of beneficial ownership disclosure requirements as a general requirement (i.e. irrespective of the industry) may not be a reality in near future, the following scenarios can be considered to achieve the required regime at least in the extractive industry:
- a. a stand-alone law implementing beneficial ownership requirements specifically for the extractive industry and subsequent harmonization of various legal acts with such standalone law; or
  - b. introduction of beneficial ownership requirements through amendment of laws referred to in paragraph 4.8 – 4.18 above.
- 7.5. While both options may yield the same result from a purely legal perspective, a stand-alone law may be viewed as having greater authority and consequently beneficial ownership requirements will not be easily circumvented by subsequent changes to relevant separate laws. This must be balanced against any additional complexity that might be introduced by such an approach. The Consultants will consult with SOFAZ, the Ministry of

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<sup>68</sup> Mongolia currently has a voluntary regime which has not proved effective.

Finance, the Commission and others to identify the most efficient and practical means of implementation.

## What Data Should be Collected?

- 7.6. Although this subject will be considered in more depth in Reports V and VI, an overview is already provided at this stage. As with the definition of “beneficial ownership”, there is no one standard agreed across all regimes although there is general agreement on the sort of information that should be collected. FATF merely states in Recommendation 24 that:

*“Countries should take measures to prevent the misuse of legal persons for money laundering or terrorist financing. Countries should ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities.”*

- 7.7. Although the EU’s AMLD4 does not prescribe what information about beneficial ownership must be collected it does require that anyone with a legitimate interest must be able to access at least the following details of any beneficial owner:

- name;
- month and year of birth;
- nationality;
- country of residence;
- nature of control
- size of interest.<sup>69</sup>

- 7.8. EITI has stated in its Beneficial Ownership Pilot Evaluation Report that:

*“Details of beneficial ownership beyond the name of the beneficial owner...i.e. date of birth, national id number, nationality, country of residence and address are necessary for the information to be useful.”*

## Current Preference

- 7.9. Whilst making no formal recommendation at this stage, the Consultants believe that the EITI list should be the minimum set of data collected for each beneficial owner and that consideration should also be given to collecting a correspondence address, the date on which the person became a beneficial owner. In addition, and despite the Consultants’ recommendation to consider introducing the Listed Company exemption after 3-5 years, Azerbaijan may decide to introduce this exemption from the start. If so and if a legal entity claims the Listed Company exemption it should provide the web link to the location where any beneficial ownership information can be located and an explanation of how ownership or control is exercised.

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<sup>69</sup> Even if by means of indicating within which sized category band the ownership interest falls, as in the UK.

## **Ensuring that Beneficial Ownership Information can be Connected to the Correct Individual**

7.10. The difficulties of identifying individuals whose names may be transliterated from the Cyrillic, Arab, Roman, Georgian or other alphabet into another can complicate the identification of any accumulation in beneficial ownership or control.

### **Current Preference**

7.11. Our current preference is that an individual should be issued with an individual unique identifier on first registration with the beneficial ownership registry and that this should be disclosed in all subsequent registrations and dealings with the registry.<sup>70</sup>

## **Open Access or Restricted Access?**

7.12. There is no standardized approach to the question of whether beneficial ownership information should be publicly available to all or whether its access should be more limited – perhaps with access only permitted to agencies of the state and those other people with a legitimate interest. The UK, the Kyrgyz Republic, the EU<sup>71</sup> and Ukraine amongst others have all introduced open access arrangements, whilst some countries (e.g. Australia and Indonesia) currently have a more limited access regime. EITI Requirement 2.5, however, is very clear on the matter - that the registry should be public. In the context of Azerbaijan, such public access would reflect GOA's stated policy goal to increase transparency in the extractive sector.

### **Current Preference**

7.13. Whilst this matter will be considered further in later reports, the Consultants currently prefer an open access registry, subject to the safeguards identified in paragraph 7.14 below and recognizing that it will require a change in existing Azerbaijani legislation on commercial secrecy and personal data, both of which will be considered in later reports. This would be in line with the approach adopted by some comparator countries, such as the UK, EU, Ukraine.

## **An Exception for Legitimate Concerns About Safety?**

7.14. If it was decided to establish “open access” to the registry, some individuals may have legitimate concerns about the public disclosure of certain items of

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<sup>70</sup> The problem of misidentification as a result of transliteration and the use of unique identifiers to resolve the issue was identified and the solution recommended by Global Witness/Open Ownership in their October 2018 “Learning the Lesson from the UK's public beneficial ownership register”.

<sup>71</sup> As part of the AMLD5.



their personal data, such as their country of residence and address.<sup>72</sup> However, these concerns should not mean that their data does not need to be disclosed to the authorities. It merely means that it should not be publicly available under specific circumstances. In the UK over one million companies registered their beneficial ownership data within 6 months of the establishment of the register, but only 270 requests for information to be held confidentially were received on the only relevant grounds (that its release would provide a serious risk of violence or intimidation due to the nature of their business), and only 5 exemptions were granted, suggesting that whilst the problem needs to be addressed it is one that will not undermine the effectiveness of the registry if handled properly.

### **Matters for Later Reports**

- 7.15. Implementation mechanisms, such as how data will be confirmed and verified, where or how data should be recorded and stored, how data can be accessed by authorized persons and/or entities, which agency should be responsible for administering the process and what penalties and other consequences should flow from a failure to comply with the requirements of the mandatory beneficial ownership disclosure regime will be dealt with in detail in later reports in accordance with the TORs.

### **Stakeholder Consultation**

- 7.16. There will be a beneficial ownership stakeholder consultation process in the period running up to, and during February 2019, focused primarily on the Beneficial Ownership Definition proposed in Chapter 6 of this report. The purpose of the consultation will be to embark on an inclusive change management process by raising awareness of the work carried out, explaining relevant concepts relating to beneficial ownership, identifying any stakeholder concerns and finding broad-based support within Azerbaijan.
- 7.17. The consultation process will encourage comments from a wide range of stakeholders, including government agencies, businesses, non-governmental organizations, etc. Stakeholders will be able to provide comments in writing, either in response to a consultation document which will be made available publicly in the English and Azerbaijani languages, together with all reports produced to date. Stakeholder comments will be accepted in English or Azerbaijani as well.
- 7.18. The consultation process will culminate in a plenary consultation event to be held in Baku in the first half of February 2019, where invited stakeholders will be able to interact directly with SOFAZ, EITC, ADB and the Consultants.

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<sup>72</sup> Although if, as in the UK, this address can be the correspondence rather than residential address, the concerns should be much reduced.

## 8. Conclusions

- 8.1. Following damaging leaks, such as the “Panama Papers”, mandatory beneficial ownership disclosure regimes have increasingly become the subject of international focus. Many countries are introducing the concept of beneficial ownership into domestic legislation and making efforts to allow disclosure of such information. Although the focus of these efforts was initially the prevention of money laundering, corruption, tax evasion and the financing of criminal activities (including terrorism), there is now a wider move in resource rich countries to increase transparency in highly lucrative extractive industries by implementing mandatory sector specific beneficial ownership disclosure regimes.
- 8.2. Whilst there is no standardized approach to the implementation of such a regime there is a high level of common understanding amongst both international organizations such as FATF, EITI, G20 and national governments as to the relevant components of a meaningful beneficial ownership disclosure regime. One key component is the adoption of a clear, legally binding “beneficial owner” definition. Again, there is no single template that reflects best practice, but there is general agreement on the constituent elements that need to be included in the definition:
  - a. a beneficial owner can be an individual natural person, a government entity or a company wholly listed on a recognized stock exchange;
  - b. a beneficial owner can exercise ownership either directly or indirectly through a series of corporate entities;
  - c. beneficial ownership covers ownership, economic interest and control i.e. a person who may not own any shares in a company but may have voting or other rights that allow that person to exercise control such as appointing or removing the majority of directors;
  - d. the information to be disclosed about natural persons includes name, date of birth, nationality, contact address, how beneficial ownership is exercised and level of ownership or control;
  - e. exemptions may be considered for specific types of companies (e.g. Listed Companies and government owned entities);
  - f. thresholds for reporting beneficial owners, depending on their nature; and
  - g. inclusion of reporting requirements for foreign and local PEPs.
- 8.3. A beneficial ownership definition must be clear and free of the risk of subjective interpretation and must reflect a country’s national priorities and policy goals, as well as its legal and regulatory framework.

- 8.4. Whilst Azerbaijani law already contains a definition of “beneficial owner” and “PEPs” in the AML Law and related financial services laws, that definition does not adequately address all key constituent elements for such a definition typically applicable in line with international good practice.
- 8.5. Based on available options that may be considered in the light of the local context and objectives, the Consultants have recommended a detailed draft definition of beneficial ownership specified in Chapter 6 of this Report. The proposed definition will underpin the mandatory beneficial ownership disclosure regime for the extractive sector in Azerbaijan. Such a regime would meet GOA’s stated policy objective of ensuring broader transparency in access to information, increasing public participation and strengthening co-operation with CSOs and its desire to ensure compliance with international good practice.<sup>73</sup>

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<sup>73</sup> See preamble to Decree of the President of Azerbaijan on Increasing transparency and accountability in the extractive industry.

## Appendix 1: Proposed Beneficial Ownership Definition Options Summary

### Part A

#### Constituent Elements of Core Beneficial Ownership Definition<sup>74</sup>

	Issue	Proposal	Alternatives	Policy considerations for/against alternative
1	<b>Natural Person</b>	A beneficial owner must be a “natural person” (see exceptions at 5 and 6 below)	None	Any alternative would undermine the purpose of the legislation
2	<b>Reference to “binding legal arrangements”</b>	Include a reference to “binding legal arrangements” as well as legal entity in the definition of beneficial owner.	It is recognized that this additional reference could be removed.	The inclusion expands the scope of the provision to capture situations of concern, but may complicate implementation.
3	<b>Ownership and control</b>	Beneficial ownership can cover ownerships or control	None	Any alternative would undermine the purpose of the legislation
4	<b>Direct and indirect</b>	A beneficial owner may exert ownership and control either directly or indirectly through a series of companies	None	Any alternative would undermine the purpose of the legislation
5	<b>Threshold for Person Disclosure</b>	The threshold for disclosure should be 20%	The threshold for disclosure should be between 5 and 25%	The lower end of this range will capture owners with potentially little influence, whilst 25% would still be consistent with the FATA and EITI guidelines and the

<sup>74</sup> See Chapters 3 and 5 of this Report and Report II Chapter for detailed discussion of these issues.

	Issue	Proposal	Alternatives	Policy considerations for/against alternative
				approach adopted by UK, EU, etc. it would however mean that Azerbaijan was seen as lying at the very top of the permitted range
6	<b>Listed Company exception</b>	Requiring beneficial owners of such companies to disclose their interests	A company listed on a recognised stock exchange can be a beneficial owner	Increased complexity. Listed companies are subject to a different disclosure regime, possibly leading to confusion.  Marginal reduction in administrative burden for companies and authorities without significant reduction in transparency
7	<b>Government Company exception</b>	A government entity may be a beneficial owner	Rather than requiring the State or Relevant Ministry to be listed as the beneficial owner, the legislation could merely state that the beneficial owner need not be registered where it is a government entity.	The Alternative would decrease transparency and fail to make it clear the omission was not just an error.
8	<b>Definition of politically exposed Persons</b>	Politically exposed persons and their family and close associates should be subject to a more onerous disclosure regime	Do not separately address Politically Exposed Persons	Failing to apply more rigorous obligations to PEP's would ignore the fact that they may be in a position to influence administrative decisions and that discovery of ownership may have a corrosive effect on confidence in state institutions.

	Issue	Proposal	Alternatives	Policy considerations for/against alternative
9	<b>Threshold for Politically Exposed Person Disclosure</b>	The threshold for the PEP disclosure regime should be 5%	Adopt a level between 0 and 25%	<p>Failing to apply more rigorous obligations for PEP's would ignore the fact that they may be in a position to influence administrative decisions and that discovery of ownership may have a corrosive effect on confidence in state institutions. The level at which mandatory reporting is required should be dictated by the level at which an active conflict of interest might arise.</p> <p>Adopting a threshold of over 5% would be out of line with international good practice and might leave Azerbaijan open to criticisms of lack of commitment.</p>
10	<b>Sectoral scope</b>	<p>The regime should apply to the extractive sector which shall mean:</p> <ul style="list-style-type: none"> <li>i) Holders of subsoil rights;</li> <li>ii) Holders of bulk processing, storage, marketing or transportation activities of extractive commodities;</li> <li>iii) Any existing or prospective contractor of</li> </ul>	<p>The regime might apply:</p> <ul style="list-style-type: none"> <li>i) To the whole economy; or</li> <li>ii) Holders of more limited rights only;</li> <li>iii) Exclude contractors.</li> </ul>	<ul style="list-style-type: none"> <li>i) Application to the whole economy would be a large undertaking that might should be considered once the more limited path-finder project has proven its worth;</li> <li>ii) Control of midstream access can be key to monetizing upstream production and generate significant value;</li> <li>iii) The extractive industries contracting sector generates significant value (especially during the development phase) and the financial, technical and HSE risks associated with a sub-optimal tendering process make disclosure of beneficial ownership a valuable tool.</li> </ul>

	Issue	Proposal	Alternatives	Policy considerations for/against alternative
		any tier providing or intending to provide services to one or more holders of relevant rights where such services have a total contract value in excess of US\$ 10,000,000 a year.		
11	<b>Legal Entities</b>	The regime should apply to all legal entities wherever incorporated, operating in the relevant sectors in Azerbaijan.	None	Any alternative would undermine the purpose of the legislation.
12	<b>Method of data gathering</b>	Existing holders of relevant rights should have to provide the required information (or confirm that there is none) within 6 months of the introduction of the legislation.  Applicants for relevant rights should be required	None	This seems to be a pragmatic response placing the burden of reporting on the parties able to comply with the minimum effort.

	Issue	Proposal	Alternatives	Policy considerations for/against alternative
		<p>to provide this information as part of the application process.</p> <p>Any existing or intending contractor of any tier providing or intending to provide services within the extractives sector in Azerbaijan to one or more holders of relevant rights where such services have a total contract value in excess of US\$10,000,000 a year shall be required to provide evidence that they have provided the necessary information as part of any tender process run by the holder of relevant rights</p> <p>Completeness and correctness of Information should be confirmed annually.</p>		



## Part B

### Look Ahead – Initial Analysis of Significant Supporting Issues and Mechanisms <sup>75</sup>

Issue	Current preference	Alternatives	Policy considerations
<b>Classes of data to be collected</b>	Name, date of birth, nationality, country of residence, nature of control, size of interest, PLUS  Correspondence address, date of commencement of beneficial ownership and the location where beneficial ownership information of a company coaming the listed company exemption can be found.	None offered	The data proposed is all relevant and should be easy to provide – if it is not then the obligation to provide should drive improved governance.  These additional pieces of information significantly increase the usefulness of the data without materially increasing the administrative burden.
<b>Use of unique identifiers</b>	A unique identifier should be issued on first registration of a beneficial owner and should be disclosed on each additional disclosure	This process might be rejected.	The risk of confusion and inability to understand a beneficial owner’s full sphere of influence would increase. Should not be unduly onerous on the administrator.
<b>Open Access or Restricted Access Registry</b>	The beneficial ownership registry information should be “open access”  Subject to an exception where those with a legitimate concern of threat as a result of disclosure of their business interests	Make the registry available only to special interest groups – e.g. law enforcement, tax, etc  None offered.	Whilst open access might require a change in Azerbaijani Law it would increase confidence in state organizations.  This is a responsible caveat which requires the individual to disclose whilst respecting their right to safety.

Source: Consultants’ research

<sup>75</sup> See Chapter 7, para 7.6 et seq. of this Report for further discussion of these issues. Source: Consultants’ research.

## **Appendix 2: Beneficial ownership Definition as Used in Current Azerbaijani Legislation<sup>76</sup>**

### **LAW OF THE REPUBLIC OF AZERBAIJAN ON THE PREVENTION OF THE LEGALIZATION OF CRIMINALLY OBTAINED FUNDS OR OTHER PROPERTY AND THE FINANCING OF TERRORISM**

This law is aimed at creating a legal mechanism to detect and prevent the offenses related to the legalization of criminally obtained funds or other property and the financing of terrorism, establishment of a regime that excludes the use of the financial system for the purposes of the legalization of criminally obtained funds or other property and the financing of terrorism, and to protect the interests of the state and public.

#### **SECTION I GENERAL PROVISIONS**

##### **Article 1. Basic definitions**

1.0. The definitions used in this Law shall have the following meanings:

1.0.12. beneficial owner – natural or legal person who ultimately obtains economic or other benefit from the transactions with funds or other property as well as the natural person who owns the legal person for the benefit of which transactions are conducted or controls the customer and (or) on whose behalf financial or other transactions are conducted or exercises ultimate effective control over a legal person;

1.0.14. politically exposed persons of foreign country – individuals who are or have been entrusted with prominent public functions in a foreign country (Heads of State or of government, senior politicians, senior government, judicial or military officials, senior executives of state-owned corporations, important political party officials), as well as their family members or close associates;

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<sup>76</sup> This definition has also now been introduced into the Law on Investment Funds and the Law on the Securities Market.

## Appendix 3: Major Contractors Holding Extractive Rights<sup>77</sup>

### Contractors in the Extractive Industry Offshore PSAs

<b>Absheron:</b>	
1. SOCAR	40 %
2. Total	40 %
3. Engie E&P Absheron B.V.	20 %

<b>Azeri, Chirag Fields and the Deep Water Portion of the Gunashli Field:</b>	
1. BP Exploration (Caspian Sea) Limited	30 %
2. Azerbaijan (ACG) Limited	25 %
3. Chevron Texaco	10 %
4. INPEX Southwest Caspian Sea, Ltd	9 %
5. Statoil Absheron A.S.	7 %
6. Exxon Azerbaijan Limited	7 %
7. Turkiye Petrolleri A.O.	6 %
8. ITOCHU Oil Exploration (Azerbaijan) Limited	4 %
9. ONGC Videsh limited	2 %

<b>The block including Bahar and Gum-Deniz fields:</b>	
1. Bahar Energy Limited	80 %
2. SOCAR	20 %

<b>Shafag-Asiman perspective structure:</b>	
1. Azerbaijan (ACG) Limited	50 %
2. BP Exploration (Caspian Sea) Limited	50 %

<b>Shah Deniz field:</b>	
1. BP Exploration (Azerbaijan) Ltd	29 %
2. Petronas Azerbaijan Shah Deniz S.A.R.L.	15 %
3. SGC Upstream LLC	7 %
4. LUKOIL	10 %
5. Naftiran Intertrade Co (NICO) limited	10 %
6. Azerbaijan (Shah Deniz) Limited	10 %
7. Turkish Petroleum Overseas Company Ltd	9%

There is also a PSA entered among SOCAR, SOCAR affiliate and Statoil Azerbaijan Ashrafi Dan Ulduzu Aypara BV for the Ashrafi, Dan Ulduzu, Aypara area (approved on 29 June 2018), and a PSA entered among SOCAR, SOCAR affiliate and BP Exploration (Azerbaijan) Limited for D230 structure (pending approval).

### Joint Venture

<b>AzGerneft LLC</b>	
1. UGE Lanser PTI. LTD	40 %

<sup>77</sup> Source: SOFAZ.

2. SOCAR	60 %
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## Onshore PSAs

<b>The block including Balakhany-Sabunchu-Ramana and Kurdakhany oil fields</b>	
1. UGE Lanser PTI. LTD	75 %
2. SOCAR	25 %

<b>Block including Binegedi, Girmaki, Chakhnaglar, Sulutepe, Masazir, Phatmai, Shabandagh and Sianshor Fields</b>	
1. Azen Oil Company B.V.	75 %
2. SOCAR	25 %

<b>Block including Kurovdagh oil field</b>	
1. Global Energy Azerbaijan	80 %
2. SOCAR	20 %

<b>Kursengi-Garabaghli fields</b>	
1. SOCAR	50 %
2. CNODC	25 %
3. Fortunate	25 %

<b>Block including Mishovdagh and Kelameddin oil fields</b>	
1. GCM Global Energy, Inc	85 %
2. SOCAR	15 %

<b>Block including Neftchala, Khilli, Durovdagh-Babazanan oil fields and South-West Flank of Mughan Monocline</b>	
1. Neftchala Investments LTD	80 %
2. SOCAR	20 %

<b>Block including Padar oil field</b>	
1. Global Energy	80 %
2. SOCAR	20 %

<b>Block including Pirsaat oil field</b>	
1. Petro Hong Kong Limited	50 %
2. Middle East	30 %
3. SOCAR	20 %

<b>Block including Surakhany field</b>	
1. Novatis OIL FZE	75 %
2. SOCAR	25 %

The block including Muradkhanli, Jafarli and Zardab oil fields	
1. Zenith Ltd.	80 %
2. SOCAR	20 %

Three blocks of South-West Gobustan	
1. Gobustan Commonwealth	40 %
2. Union Texas	40 %
3. SOCAR	20 %

Block including Zıgh and Hovsan oil fields	
1. Absheron Investments	75 %
2. SOCAR	25 %

### Risk Sharing Agreement (RSA)

Offshore block in the Caspian Sea including Umid field and Babak prospective structure	
1. SOCAR	
2. SOCAR Umid Oil and Gas Limited	

Appraisal and development of the Qarabagh oilfield	
1. SOCAR	
2. SOCAR Qarabakh LLC	
3. Statoil Azerbaijan Qarabagh B.V.	

### Gold mining

Prospective Gold Mining Area of Kedabek, Gosha, Ordubad Group (Piazbashi, Agyurt, Shakardara, Kilyaki), Soutely, Luzilbulag and Vejnaly deposits	
1. Azerbaijan Ministry of Ecology and Natural Resources	51 %
2. Anglo Asian Mining PLC	49 %

AzerGold CJSC Mining Projects	
1. Chovdar ore field	
2. Kohnamadan (Filizchay and Mazimchay mine deposits)	
3. Kurakchay area	
4. Goydagh (Goydagh-Alindzha ore junction)	
5. Daghkasan ore field	
6. Garadagh deposit	

Source: Consultants' research

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