# Part 3. Where Does the Beneficial Owner Hide?

*"Vice knows she's ugly, so puts on her mask."*

— Benjamin Franklin

## 3.1 Introduction

This study revealed that, in the vast majority of grand corruption cases we analyzed, corporate vehicles—including companies, trusts, foundations, and fictitious entities—are misused to conceal the identities of the people involved in the corruption. Of these corporate vehicles, the company was the most frequently used. Investigators confirmed this misuse, noting that locating information about the person who is in control of a corporate vehicle was essential to any large-scale corruption investigation, and indeed, to almost any large-scale organized-crime investigation. Despite the widespread misuse of corporate vehicles for criminal purposes (including corruption, financing terrorism, money laundering, and fraud), most countries have no coherent strategy to tackle this problem. This chapter identifies the types of corporate vehicles used to conceal the identity of the person involved in the corruption and other obstacles that investigators may face. An overview of each of these corporate vehicles is given in appendix C.

## 3.2 Corporate Vehicles: Types and Features

This section describes the various types of corporate vehicles that have been used in grand corruption schemes. We distinguish four distinct categories:

- Companies
- Trusts
- Foundations
- Fictitious entities and unincorporated economic organizations.

(Fictitious entities is an outlier category, encompassing sole proprietorships, the various forms of partnerships, and other functionally effective equivalents.) We provide an overview of the main characteristics of these corporate vehicles. Their precise nature, the ways in which they are misused for criminal ends, and the extent to which they are misused vary from jurisdiction to jurisdiction; nonetheless, our study revealed a number of global similarities.

### 3.2.1 Companies

Companies were used to hide the proceeds of corruption in 128 of the 150 cases of grand corruption reviewed. The legal characteristics distinguishing public from private companies, as well as limited liability companies and more recent offshoots, are given in appendix C. The more relevant distinction made to tackle corruption relates to each company's purpose rather than to their legal definition. In this part of the report, we consider both companies that are intended primarily to hold assets or liabilities and companies that are intended primarily for the purpose of engaging in business activity in some industry.[20]

### Shell Companies

In more than half of the cases analyzed that involved any sort of company,[21] that company was a "shell company." For our purposes, a shell company can be defined as a non-operational company—that is, a legal entity that has no independent operations, significant assets, ongoing business activities, or employees.[22] In a case study on money laundering involving Riggs Bank, a U.S. Senate report declared that, "In many instances, a private banker will set up [a] shell corporation for a client and open accounts in the name of that shell corporation, in order to disguise the client's ownership of the account or certain assets."[23] Box 3.1 describes how a shell company is set up.

Nonetheless, as long as compliance officers have access to trustworthy information for due diligence, they are generally comfortable providing financial services for nonoperational

20. The terminology used in this section includes some working definitions that at times may be ambiguous. The demarcation between types of companies often is not clear-cut. One type of entity may simultaneously fall into several of the categories distinguished in this part of the report. We have offered industry usage terminology when possible and to clearly contrast our usage with other common usages.

21. For roughly a quarter of the investigated cases involving companies, we were unable to determine with certainty whether the involved corporate vehicles were shell companies; it is at least possible that a number of the unknowns were in fact shell companies.

22. The Financial Action Task Force on Money Laundering (FATF) Recommendations make no use of the term "shell company" per se, but do mention "shell banks" in Recommendation 18, and the glossary definition, "[. . .] a bank incorporated in a jurisdiction in which it has no physical presence and which is unaffiliated with a regulated financial group," comes closer to our intended usage by focusing on tangibility rather than illicit intent. In "Behind the Corporate Veil" (Paris: OECD 2001), p. 17, shell companies are defined as follows: "Companies, which are entities established not to pursue any legitimate business activity but solely to obscure the identity of their beneficial owners and controllers, constitute a substantial proportion of the corporate vehicles established in some OFCs [offshore financial centers]." This definition was unsuitable for our needs because it implies an illicit purpose. Ambiguities remain, as certain businesses necessitate the existence of a holding company that holds the shares in one or more operational companies. Given historical usage, referring to such a company as a "shell" may have a pejorative connotation. As a final point of clarification, "significant assets" refers to operationally necessary assets meant primarily to benefit the company rather than its owners (for example, office space, furniture, computer or industry-specific equipment). The major concern raised by shell companies is that they often possess financial assets—cash, stock, titles to property, and so on.

23. U.S. Senate Permanent Subcommittee on Investigations, Committee on Governmental Affairs, *Money Laundering and Foreign Corruption Enforcement and Effectiveness of the Patriot Act, Case Study Involving Riggs Bank*, July 15, 2004, p. 13.

### BOX 3.1 Setting Up a Shell Company

Interviews with trust and company service providers (TCSPs) conducted in the context of this study showed that it is not expensive or time-consuming to establish an anonymous shell corporation. A company-formation agent's fees range from US$800 to US$6,000 as an upfront cost, followed by a slightly smaller amount on an annual basis. Costs may vary, depending on whether the service provider provides additional services, such as nominee director or shareholder arrangements, filing of any annual documentation, or phone and mail forwarding. At the upper end of this price range, in six cases, service providers (perhaps perceiving deceptive intent) recommended holding the ownership of the shell company in an overarching trust or foundation that undoubtedly would present additional obstacles to investigating authorities seeking to identify the beneficial owner.

(For more information see the Trust and Company Service Providers Project in appendix B.)

company clients; as such, "hollow" companies are commonly formed to serve a variety of legitimate economic functions. One such function is to facilitate a merger: two companies will structure this transaction so that they merge under a third, neutral shell company. Companies entering into a joint venture also use shell companies. In a multinational transaction, many companies prefer to seat their international joint-venture company in a neutral jurisdiction to ensure that no one company receives preferential legal treatment. In addition, shell companies are also used to sequester liabilities, to create distinctive equity or debt tranches in a single asset, to serve as a personal holding company, or to serve as a company holding personal or family assets for ease of inheritance or as protection against attachment by creditors.

One specific type of shell company structure is the international business corporation (IBC) (see appendix C). IBCs are typically used for shell companies set up by nonresidents in offshore financial centers (OFCs). By definition, IBCs make ideal shell companies, because they are not permitted to conduct business within the incorporating jurisdiction and generally are exempt from local income taxes.

Unlike normal companies, shell companies have no economic activity, which makes it difficult to find out much information about them. A normal company that is engaged in business will typically market itself, join a chamber of commerce, build a website, buy space in the phonebook, sponsor youth sporting events, and purchase supplies and equipment. It will have employees who can be interrogated, keep meeting minutes that may be consulted, and produce financial data that can be compared with normative industry benchmarks. A non-operational company like a shell company may do some of these things (companies are often obligated to hold a meeting of shareholders once a year), but it probably does not have to.

This study's review of grand corruption cases reveals that shell companies, when used illicitly, are generally used in combination with additional mechanisms to obscure

beneficial ownership. The mechanisms include exercising control surreptitiously through contracts (rather than "standard" ownership and control positions), adding layers of corporate vehicles, hiding behind bearer shares, and ensuring that the beneficial owners are located (or the identifying information is stored) in another jurisdiction. See box 3.2 for an example of how a shell company was misused.

## BOX 3.2 Misusing a Shell Company

*The Case of Anthony Seminerio (United States)*

On February 4, 2010, the U.S. Attorney for the Southern District of New York announced that Anthony Seminerio was sentenced to six years in prison for defrauding the people of New York of his honest services as an assemblyman in the New York State legislature. Seminerio was also ordered to pay US$1 million in forfeiture.[a] As described in the Government's Sentencing Submission of November 6, 2009, from about 1998 through about September 2008, Anthony Seminerio engaged in a scheme to defraud the public of his honest services through the use of a purported consulting firm, named "Marc Consultants." Seminerio used Marc Consultants to solicit and receive payments of hundreds of thousands of dollars from persons and entities, in exchange for which Seminerio took official action for the benefit of those entities, resulting in favorable treatment for those entities in the Assembly and by New York state officials.

Moreover, because New York's Public Officers Law permits a member of the Assembly to report income in the name of a business, rather than in the names of the individual clients of that business, Seminerio used Marc Consultants to conceal these corrupt payments from public scrutiny. In fact, Seminerio did little or no consulting work.[b] The government stated that "bank records demonstrate that Marc Consultants was a shell company." The records for an account held in the name of Marc Consultants demonstrate that Seminerio used the Marc Consultants bank account not to handle payments and receipts relating to a genuine consulting business, but rather as an account through which to receive corrupt payments in connection with official acts and to fund his personal expenses.

According to bank records,

- the address listed on the Marc Consultants bank account is the home address of Seminerio,
- the sole individuals with signature authority for the Marc Consultants bank account are Seminerio and his wife, and
- no disbursements from the Marc Consultants bank account were made to any employees or to any payroll companies.[c]

*Note:* a. Federal Bureau of Investigation, New York Field Office Press Release, "Former New York State Assemblyman Sentenced to Six Years in Prison for Public Corruption Crimes," released February 4, 2010; available at http://newyork.fbi.gov/dojpressrel/pressrel10/nyfo020410.htm.
b. US v. Anthony Seminerio, Case No. 1:08-cr-01238-NRB (S.D.N.Y.), Sentencing Submission of the USA, filed on November 6, 2009, at 1.
c. US v. Anthony Seminerio, Case No. 1:08-cr-01238-NRB (S.D.N.Y.), Sentencing Submission of the USA, filed on November 6, 2009, at 5.

### *Shelf Companies*[24]

The term "shelf company" is typically (although not uniformly) applied to a company that (a) is incorporated with a standard memorandum or articles of association; (b) has inactive shareholders, directors, and secretary; and (c) is left dormant—that is, sitting "on a shelf"—for the purpose of later being sold (see box 3.3). When the shelf company is sold, the inactive shareholders transfer their shares to the purchaser, and the directors and secretary submit their resignations. Upon transfer, the purchaser may receive the company's credit and tax history. It is possible that the company director(s) will continue in function as nominees, in which case, the outside world only sees a change of ownership—assuming, that is, that the change in ownership is actually registered somewhere, which is not necessarily the case. Until such time as the purchaser may choose to start up operational activity using the shelf company, it also may be considered a shell company.

**BOX 3.3 Using Shelf Companies to Conceal Ownership of Bank Accounts**

*The Scheme of Raul Salinas (Mexico)*[a]

Raul Salinas, brother of former Mexican President Carlos Salinas, transferred to the United States US$100 million in questionable assets using a private banking relationship formed with Citibank. Between 1992 and 1994, Citibank assisted Salinas's transfers and effectively disguised the source and destination of the funds by employing shelf companies. Upon setting up the offshore private investment company, Trocca Ltd., to hold Salinas's assets, Citibank appointed three Panamanian shelf companies—Madeline Investments S.A., Donat Investments S.A., and Hitchcock Investments S.A.—to serve as Trocca's board of directors. All three of these companies had been incorporated in 1979, nearly 15 years before Trocca's incorporation. In addition, another shelf company from the Cayman Islands, Tyler Ltd., incorporated in 1984, was named as a principal shareholder. With the help of Citibank, Salinas avoided his name being connected to the scheme by circumventing the incorporation process, and thus no documentation identified Salinas as beneficial owner of the accounts.

*Note:* a. U.S. General Accounting Office (now known as Government Accountability Office), Report to the Ranking Minority Member, Permanent Subcommittee on Investigations, Committee on Governmental Affairs, U.S. Senate, "Private Banking: Raul Salinas, Citibank and Alleged Money Laundering," GAO/OSI-99-1 (October 1998); United States Senate Permanent Subcommittee on Investigations, S. Hrg. 106–428, "Private Banking and Money Laundering: A Case Study of Opportunities and Vulnerabilities," November 9 and 10, 1999, Government Printing Office, available at http://www.gpo.gov/congress/senate/senate12sh106.html.

24. It was not possible to determine the exact number of shelf companies involved in the cases in our grand corruption database. We were able to establish that a shelf company was involved in a small number of cases (six) in which a considerable amount of time lapsed between the company being established and it being used in a scheme (see, for example, the Salinas case in box 3.3). Because a lot of shelf companies are bought just after having been incorporated, however, the time lapse may be only a few months. It is consequently difficult to know whether one is dealing with a shelf company or a company incorporated by a service provider and sold on, especially when it proves impossible to trace the company's establishment history.

The typical advertisement in box 3.4 mentions the benefits for shelf corporations and aged corporations. The price of an "aged" shelf company available for immediate purchase tends to vary depending on how long it has existed. For example, for a company less than five years old, one might expect to pay US$1,000 per year that the company has existed. In the case of a company more than 10 years old, this sum might increase to US$35,000. Costs increase in cases in which the shelf company offers additional benefits, such as pre-existing lines of credit, maintained records, and bank accounts.

Service providers may hold a stock of shelf companies, purchased in bulk from a company wholesaler. Shelf companies have the advantage that one does not need the time to set up a new corporation. In some jurisdictions, incorporation procedures can be time-consuming, so it is often easier, quicker, and less expensive to transfer ownership of a shelf company than it is to incorporate a new one. In some countries, however, the formalities of setting up a company have been so reduced—in some cases to just completing a simple form online—that the difference in terms of timing between buying a shelf company and setting up a new one are minimal. Consequently, the typical justification for buying a shelf company—"I need a company now, not in six weeks"—is losing validity.

Law enforcement authorities are concerned about shelf companies, because

> criminals can easily throw investigators off the trail by purchasing shelf companies and then never officially transferring the ownership [*i.e.,* registering with the authorities] . . . [I]n such

**BOX 3.4 A Typical Advertisement for "Shelf Corporations and Aged Corporations"**

*Establish Immediate Corporate History*

*Companies Incorporated holds a list of "pre-filed," **off-the-shelf companies** that you can acquire. By owning a pre-established corporate identity, you are able to **take advantage of the following benefits**:*

1. *Instant availability and fast delivery*
2. *Immediately own a company with a corporate history*
3. *Show longevity and enhance your image with customers and lenders*
4. *Easier to obtain business credit cards and business credit lines*
5. *Often, lenders require a business to have been in existence from six months to two years or more before lending it money*
6. *Ability to borrow money from banks*
7. *Ability to secure bids on contracts. Many agencies will only sign contracts with a business that has been in business for at least two years.*

*All entities are in good standing through maintenance, reinstatement, revival, or the equivalent. Your company name can be changed for a small fee.*

*Source:* CompaniesIncorporated®, "Shelf Corporation & Aged Corporations," http://www.companiesinc.com/corporation/aged (accessed July 20, 2011).

cases the investigation often leads to a [dead-end] formation agent who has long ago sold the company with no records of the purchaser and no obligation to note the ownership change.[25]

### *Operational Entities*

The misuse of legal entities is often regarded almost exclusively as being a problem of non-operational companies. This study's analysis of the grand corruption cases, however, reveals that a significant proportion of the schemes (approximately one in seven) misuse operational companies (that is, "front companies"). Operational entities have inflows and outflows of assets, which enables streams of illicit assets to be mingled with legitimate funds and thereby laundered. Thus, substantial amounts of money can be transferred without raising suspicion. One supervisory authority interviewed for this project indicated that the misuse of operational entities for money laundering purposes is a significant and growing problem. The case described in box 3.5 demonstrates the lengths to which criminals will go to gain control of operational entities (in this case, a bank) that will allow them to pass off their illicit assets as something less malignant.

Front companies may be involved in the giving and receiving of bribes. Although unaffiliated individuals may offer bribes to public officials to court favor, the most financially significant instances of bribery, kickbacks, and self-dealing[26] are undertaken by persons working for big corporations.

The case studies of grand corruption investigations identify two schemes that are typically used in cases in which the bribes or kickbacks take monetary form. In one case, the giver of the bribe either creates or contracts with a consulting company to receive and pass on funds to the bribe receiver, thereby obscuring the chain of payment and creating a plausible explanation for the payments. In the second case, the recipient of the bribe creates a corporate vehicle to hide the assets and any connection that he may have to them. In cases in which the official is given a concealed stake in the venture or the company offering the bribe, these corporate vehicles become the opaque link between the corrupted party and the wealth acquired.

Those responsible for active bribery (that is, giving the bribe) sometimes hide behind the fact that although they are in a position to authorize transactions, they are not the beneficial owner of the company. In at least one-third of the cases in our database, bribery or kickback investigations led to operational companies entering into

25. Statement of Jennifer Shasky, then Senior Counsel to the Deputy Attorney before the Committee on Homeland Security and Governmental Affairs, U.S. Senate, "Business Formation and Financial Crime: Finding a Legislative Solution," presented November 5, 2009; available at http://www.google.com/url?sa=t&source=web&cd=1&ved=0CBIQFjAA&url=http%3A%2F%2Fhsgac.senate.gov%2Fpublic%2Findex.cfm%3FFuseAction%3DFiles.View%26FileStore_id%3D1c13f428-29f0-47fa-b5d3-6334f51aac0a&ei=86lyTKbmG8WBlAf3ls2cDw&usg=AFQjCNEx1wZRRI_e49v-45Nk6QOWWgmNoQ&sig2=lbwTpXbVzgfN8oyynXTrzg.

26. The hiding of beneficial interests given to or belonging to those public officials tasked with the award of contracts.

## BOX 3.5 Laundering Money through a Front Company

*The Case of Pavel Lazarenko, Former Prime Minister (Ukraine)*

The European Federal Credit Bank (EuroFed) featured prominently in the U.S. prosecution and conviction of former Ukrainian Prime Minister Pavel Lazarenko on charges of money laundering and conspiracy to commit money laundering.[a] In early 1997, when Lazarenko faced corruption allegations in Ukraine and believed that he soon would lose his post, he and his coconspirator Peter Kiritchenko[b] learned that EuroFed, an offshore bank domiciled in Antigua, was for sale and agreed to buy it.[c] According to an opinion issued by the U.S. District Court for the Northern District of California, "Lazarenko opened his own personal account at EuroFed, and in August 1997, Lazarenko and Kiritchenko purchased a 67 percent interest in the bank." The indictment against Lazarenko had alleged that "It was further part of the conspiracy that in May of 1997, Kiritchenko and Lazarenko began negotiations to purchase, and by August 7, 1997, purchased, a [67 percent][d] share of European Federal Credit Bank in St. John's, Antigua, in order to facilitate the transfer of money and to further conceal and disguise the nature, origin, location, source, ownership and control of the money that was paid for the benefit of Lazarenko."[e] The indictment added that "[B]etween May and September 1997, Lazarenko transferred approximately US$70 million into accounts he and Kiritchenko controlled" at EuroFed.[f] In 2005, the U.S. Department of Justice filed a civil asset forfeiture case to seize Lazarenko's assets, including approximately US$85.5 million alleged to have been formerly on deposit in accounts held for his benefit at EuroFed.[g]

*Note:* a. US v. Lazarenko, No. 06-10592, 564 F. 3d 1026 (9th Cir. 2009). Lazarenko was prime minister from May 1996 to July 1997.
b. Lazarenko was convicted in the United States of having extorted US$30 million from Peter Kiritchenko, a Ukrainian businessman, who first approached Lazarenko in 1992. However, Kiritchenko soon turned from victim of extortion to co-conspirator, playing a key role in the former prime minister's money laundering scheme, a role that continued after his move to San Francisco in 1994. *US v. Lazarenko,* 564 F. 3d 1026 (9th Cir. 2009).
c. US v. Lazarenko. Case No. 00-cr-00284-CRB, 575 F. Supp. 2d 1139, 2008 U.S. Dist. LEXIS 71387 (N.D. Cal), Opinion issued on August 22, 2008, at 1141.
d. US v. Lazarenko. Case No. 00-cr-00284-CRB, 575 F. Supp. 2d 1139, 2008 U.S. Dist. LEXIS 71387 (N.D. Cal.), Opinion issued on August 22, 2008, at 1141.
e. US v. Lazarenko, Case No. 00-cr-0284-CRB (N.D. Cal.), Indictment filed May 18, 2000, Count 1 Conspiracy to Commit Money Laundering, at para. 21.
f. Ibid at para. 22. The purchase took place a month after Lazarenko was pressured to step down as prime minister in July 1997. *US v. Lazarenko,* 564 F, 3d 1026 (N.D. Cal.), Opinion issued on August 22, 2008. In the fall of 1999, acting on a request by the Ukrainian authorities, the Antiguan government began an investigation of EuroFed for alleged money laundering activities and froze its assets.
g. US v. All Assets Held at Bank Julius Baer & Company, Ltd., et al., Case No. 1:04-cv-00798-PLF (D.D.C.), First Amended Verified Complaint for Forfeiture In Rem, filed June 30, 2005.

settlements with or without being convicted by the authorities. In one typical case, IBM accepted a settlement with the U.S. Securities and Exchange Commission when people at IBM's Argentina subsidiary—without the knowledge or approval of U.S. employees or IBM shareholders—engaged in a relationship with a subcontractor to pass along millions of dollars for distribution to directors of Banco de la Nacion.[27]

27. In the Matter of International Business Machines Corp., Administrative Proceeding File No. 3-13097, Rel. No. 34-43761, Dec. 21, 2000 (settlement), pp. 2–3. In instances such as this, the corporations

In these instances, the company provides an essential veil, but the overarching legitimate activities of the company are what truly provide the cover for transactions used to bribe officials. These transactions are usually small enough not to attract the attention of internal control, management, or shareholders. Therefore, it is not the beneficial ownership of the legal entity as a whole that is important, but rather the control over specific transactions.

### *Companies with Bearer Shares or Share Warrants*

Bearer shares often come up for discussion in the context of anti-money laundering (AML) measures because they allow for anonymous transfers of control. Bearer shares are company shares that exist in certificate form, and whoever is in physical possession of the bearer shares is deemed to be their owner. Transfer requires only the delivery of the instrument from person to person (in some cases, combined with endorsement on the back of the instrument). Box 3.6 shows just how easy it is to set up a company with this type of instrument. Unlike "registered" shares (for which ownership is determined by entry in a register[28]), bearer shares typically give the person in possession of the certificate (the bearer) voting rights or rights to dividend. Almost identical in terms of function are unregistered "share warrants."[29] A share warrant may be thought of as a voucher entitling the holder to the right to acquire shares. Concerns have been raised in AML forums that companies that issue bearer shares are used extensively for illegal activities, such as tax evasion and money laundering (see box 3.7).[30]

In most jurisdictions, bearer-share statutes have generally been undergoing a process of reform and elimination, typically being phased out through "dematerialization" or "immobilization." Dematerialization requires bearer shares to be computerized and registered in company ledgers, thereby negating their status as an "unregistered" instrument.[31] Immobilization requires the bearer share to be placed with a custodial agent,

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themselves (for example, IBM and others) are not included in our database because, unlike the intermediate companies, they were not themselves used to conceal payments.

28. Although the register may have a certificate of the security evidencing title, possession of this certificate is not relevant to legal ownership. Transfer of a registered security is effected by an amendment of the register.

29. "There is a slight distinction between 'share warrants to bearer' and 'bearer shares'. The former give the bearer an entitlement to the share therein specified, whereas the latter refer to negotiable instruments that accord ownership in a corporation to the person who possesses the bearer share certificate." *Tax Cooperation 2009: Towards a Level Playing Field* (Paris: OECD, 2009), p. 213.

30. Without doubt, such a reputation arises in part from the terms by which some businesses market these entities, for example: "The trick behind Bearer Shares, however, is that they must be issued properly by a qualified and knowledgeable corporate director. *As long as you do not have them in your possession at the time you are questioned, you can legally and truthfully say under oath, 'I am not the owner of that corporation.'* [. . .] If your nominee officer is ever questioned about your corporation, *he can say the same thing: 'Bearer shares were issued, I don't know who owns the company, and I can prove it.'* [. . .] *it is impossible to know for certain who the shareholders of the company are.* Because a transfer of the shares can be made by simply handing them to another person, bearer shares can be transferred more easily than non-bearer shares" (italics added). Coddan Companies Formation Worldwide, http://www.coddan.co.uk/s-9-uk-bearer-shares-company-formation.html (accessed July 22, 2011).

31. For example, a Belgian law of December 14, 2005, provides for the phasing out of bearer shares in all domestic companies.

## BOX 3.6 Setting Up Companies with Bearer Instruments

*André Pascal Enterprises (England and Wales)*

André Pascal Enterprises[a] was an England and Wales Private Company Limited by Shares (with bearer-share warrants) set up by a U.K. corporate service provider. Upon payment and submission of the order to set up the company, the provider electronically lodged the application with U.K. Companies House. The provider became the initial shareholder of the company and subscriber to the Memorandum and Articles of Association for the purposes of government records. Upon receipt of signed documents from the client—but without requiring or requesting the client to provide any supporting identification—the provider issued bearer-share warrants, erasing the provider's name from the share registry without substituting any other. André Pascal Enterprises had a nominee director and nominee secretary (courtesy of the provider), again providing separation from the beneficial owner. The incorporation process took less than a day, filling out the online forms took 45 minutes, and the total cost was £515.95.

*Note:* a. This company was set up as part of the TCSP project.

## BOX 3.7 Misusing a Bearer-Share Company

*The Case of Former President Frederick Chiluba (Zambia)*[a]

Iqbal Meer, a London-based solicitor, was among the defendants in a private civil asset recovery action brought by the Zambian attorney general in the U.K. High Court against his law firm and others for their role in assisting President Frederick Chiluba and his director general of the Zambian Security and Intelligence Services (ZSIS), X. F. Chungu, to funnel funds stolen from the Zambian government. In his judgment delivered on May 4, 2007, Mr. Justice Peter Smith held that Meer had incorporated a British Virgin Islands International Business Company, Harptree Holdings Ltd., with the company's bearer shares held in trust by a nominee at Bachmann Trust Company Ltd. Harptree Holdings had been formed to purchase real estate in Belgium—a block of flats and an apartment hotel—to pay off one of the co-conspirators in the case, Faustin Kabwe, who was identified in the court's judgment as a close friend and financial adviser to Chiluba and Chungu. This involved the transfer of funds from Zambia's ministry of finance to an account in London (referred to as the Zamtrop account) and from that account to a Zambian financial services company, in which Kabwe was one of the main controlling officers. Suspicions of Meer's involvement in this Zamtrop conspiracy (as it later became known) resulted in the U.K. Office for the Supervision of Solicitors paying Meer a visit in April 2003. They asked him specifically about the ownership of Harptree. He responded, "I have no idea whether Kabwe is holding the bearer shares in his hands or whether somebody else is holding

*(continued next page)*

BOX 3.7 *(continued)*

[the] bearer shares"—demonstrating clearly how a bearer-share construction can allow someone to easily and accurately deny knowledge of ownership of a legal entity.

Mr. Justice Smith concluded:

*In my view it is obvious. The (. . .) purchase was FK's [Faustin Kabwe's] payoff for his role in the conspiracy. IM [Iqbal Meer], whilst he did not know the overarching conspiracy details, took instructions from FK on behalf of Harptree, because he believed it belonged to him beneficially. Yet he knew that the purchase was funded by government monies via the Zamtrop account but did not question FK's entitlement to them. That failure (even if his case that it was a ZSIS purchase is to be believed) and the failure to record that matter in any document are actions again which an honest solicitor would not do. Such a large purchase of a block of flats and an apartment hotel cannot conceivably have been regarded as a purchase for ZSIS operations. Equally, the labyrinthine routing of the ownership of the properties—via a BVI holding company with nominee directors and bearer shares and a Luxembourg company interposed—shows that the whole operation was to hide things.*

*Source:* Supplemented by additional details from the Approved Judgment of Justice Peter Smith in the matter of *AG of Zambia v Meer Care & Desai and Others*, [2007] EWHC 952 (Ch). Case No: HC04C03129. Dramatis Personae, ¶¶593–601.
*Note:* a. While Iqbal Meer was originally found liable for dishonest assistance, this portion of the ruling was overturned on appeal on the grounds that only negligence had been demonstrated (Zambia v Meer Care & Desai [2008] EWCA Civ 1007).

who holds the share for the beneficial owner, thereby preventing the holder from making unrecorded transfers.[32]

Financial compliance officers and company service providers report that bearer shares have generally been frozen out of the financial sector even if they are still permitted by the laws of a particular jurisdiction. No bank with any sort of due diligence standards is willing to conduct business with a company that has free-floating bearer shares. Companies that are not required under their own laws to have bearer shares immobilized will typically have to place the share in the trust of an agent of the bank, as a condition of being accepted as a customer.

Some jurisdictions require the involvement of intermediaries in the transfer of bearer shares for the transfer to be lawful and thus ensure that each change in ownership is

32. In the British Virgin Islands, companies incorporated since January 1, 2005, had been required to lodge bearer-share certificates with custodians. Companies incorporated before that date had not been subject to such immobilization procedures, but as of 2010, they became subject to more stringent regulations: they generally would be deemed to no longer have any ability to issue bearer shares, and any existing bearer shares had to be deposited with a recognized or authorized custodian. Furthermore, the deposit with the custodian would not be deemed valid until a registered agent had received notification or proof of the deposit from an authorized custodian. See BVI Business Companies (Amendment) Act 2005, Sections 67–77.

registered. Panama remains a noteworthy exception to this trend, because thus far, it has not implemented any policy to immobilize or dematerialize bearer shares.[33] Investigators noted, however, that Panamanian banks generally refuse to conduct business with companies with bearer securities, and the director of such a company must sign a notarized declaration of knowledge of the beneficially interested shareholder to be able to conduct business with a bank.

Given the legislative reforms of the past decade and the fact that bearer shares or share warrants featured in roughly 1 percent of the grand corruption cases we reviewed, one might be inclined to consider bearer securities to be a problem of the past. Investigators interviewed for this study from Latin America and the Caribbean disagree, however. They maintain that bearer-share companies are still a problem for money laundering investigations, that their anonymity prevents detection and impedes prosecution, and that corrupt individuals still can gain access to financial systems and undertake anonymous transactions involving considerable sums.

In practice, there is scant business rationale for the continued use of bearer securities. The claims that bearer securities are necessary to facilitate transfer of ownership and enhance liquidity no longer hold for the vast majority of countries. An electronic system of registered shares is clearly a more efficient platform for transferring equity interests. In this case, the risks outweigh the benefits.

### *3.2.2 Trusts*

Our review of grand corruption investigations suggests that trusts are used infrequently. In fact, only 5 percent of the corporate vehicles identified were trusts, appearing in only about 15 percent of the investigations. The misuse of trusts was found in schemes originating with corrupt government officials in all parts of the world. It appeared most in Latin America, the Caribbean, and high-income nations. Unfortunately, in most cases, the legal documentation available failed to identify the jurisdiction of origin (that is, the country under whose laws the trusts were organized). In cases in which the jurisdiction could be identified, however, these schemes were found predominantly in the U.S. states, the Bahamas, the Cayman Islands, and Jersey.

33. "Decree 524 of 2005 establishes the registration requirement for associations and non-profit foundations. Except for this development, none of the actions recommended in the evaluation report have been taken: (a) corporate services providers (mostly lawyers) are not subject to an adequate AML/CFT [anti-money laundering/combating the financing of terrorism] regime; (b) no measures have been taken to avoid the possible use of bearer shares for unlawful purposes; (c) no obligation has been imposed to update information on the ownership of legal persons in the public registry of property, or for the strengthening of registration to enable more timely and accurate information to be provided; and (d) corporate law has not been revised to ensure that operators of justice and other authorities can access useful information on the beneficial ownership of legal entities established in Panama." Caribbean Financial Action Task Force, "Panama: Follow-up Report to Mutual Evaluation Approved September 2006," February 2009, p. 4, available at http://www.cfatf-gafic.org/.../Panama_1st_Follow-Up_Report_(Final)_English.pdf (accessed July 21, 2011).

In principle, a trust service provider will serve as trustee and thereby have effective control over the trust. In practice, the originator of the trust ("the settlor") may share in these responsibilities or exert influence through other mechanisms. Although it was once considered to be a guiding principle of trust law that a settlor must give up effective control of any assets placed into a trust, many jurisdictions have fundamentally modified this requirement.[34] These modifications make it possible for a settlor not only to be listed as a beneficiary, but also to maintain control over the trust by serving as a co-trustee or protector, with the power to veto trustee decisions or even to replace them.[35] The modifications also make it possible for a trust to be created by a settlor but funded by some other party (the "economic settlor"), whose name need not appear on any documents pertaining to the trust.

The relatively small numbers of grand corruption investigations in this study involving the abuse of trusts seemingly contradicts a popular perception that those perpetrating illicit activities find trusts and similar legal arrangements particularly useful and frequently misuse them for that purpose.[36] Indeed, service providers approached for the audit studies often recommended the use of stand-alone trusts or a combination of a company and a trust for holding assets. The design of trust laws in many jurisdictions may make it difficult for creditors to sue, prevail in court, or collect awarded monies. For example, authorities may not recognize the laws of other jurisdictions, may not recognize and enforce foreign judgments,[37] and may fail to apply laws against transferring assets to avoid creditors.

Investigators interviewed as part of this study argued that the grand corruption investigations in our database failed to capture the true extent to which trusts are used. Trusts, they said, prove such a hurdle to investigation, prosecution (or civil judgment), and asset recovery that they are seldom prioritized in corruption investigations.

34. "[O]ne ought not control and benefit from property and at the same time shield it from one's creditors." Elena Marty-Nelson, "Offshore Asset Protection Trusts: Having Your Cake and Eating it Too," *Rutgers L. Rev*. 47, no. 11 (1994–95), p.15.

35. See, for instance, the Nevis International Trust Ordinance. Initial legislative assessment efforts found only two nations (out of 40 reviewed) that, by statute, restrict a settlor's powers in trust administration.

36. "[T]rusts which hide the identity of the grantors and the beneficiaries have become a standard part of money laundering arrangements." Jack A. Blum, Esq., Prof. Michael Levi, Prof. R. Thomas Naylor, and Prof. Phil Williams, *Financial Havens, Banking Secrecy and Money Laundering* (United Nations Office for Drug Control and Crime Prevention, Global Programme Against Money Laundering, 1998), p. 95. See also European Commission and Transcrime, University of Trento (Italy), *Euroshore: Protecting the EU Financial System from the Exploitation of Financial Centres and Off-shore Facilities by Organized Crime* (January 2000), p. 46: "Trusts can be easily exploited for money laundering purposes, considering the rules governing them," such as those that do not require the disclosure of the identity of the beneficiary or of the settlor, those which do not require any governmental license to operate. Some jurisdictions allow for a "flee clause," "pursuant to which "the trustee is able to move the trust from one jurisdiction to another in the event of criminal investigation." See also the FATF Typologies Report on the Misuse of Corporate Vehicles (2006), p. 61: "Responses to the questionnaires [sent out for the purposes of this study] support the conclusion that Trusts and Private companies are the vehicles that are most susceptible to abuse."

37. See, for example, Anguilla Trusts Act, Bermuda Trust (Special Provisions) Amendment Act 2004, Trusts (Guernsey) Law 2007, and Nevis International Trust Ordinance.

## BOX 3.8 Misusing a Trust

*The Case of Diepreye Alamieyeseigha, Former Governor of Delta State (Nigeria)*

In May 2001, on the advice of UBS bank (UBS), Diepreye Alamieyeseigha settled a Bahamian[a] trust—the "Salo Trust"—for the benefit of himself[b] and his family.[c] He contended that, because the UBS account, although legally in his name, was a trustee account for the benefit of his wife and children (he was purportedly unaware of his own status as a trust beneficiary), he did not list the account on his Declaration of Assets form that all Nigerian state governors are constitutionally required to submit.[d] Alamieyeseigha thus admitted to being (a) the settlor; (b) the trustee (insofar as the UBS account, legally opened and controlled in his own name, was held to be a trustee account); and (c) a beneficiary. Clearly, this was a trust in name only, with no effective legal separation between himself and the asset.

In the first claim made against Alamieyeseigha and his companies in early 2007, Mr. Justice Lewison held that it was established by documentation that, in 1999, Alamieyeseigha opened a London account with UBS with an initial deposit of US$35,000 and a balance in 2005 of US$535,812 from various sources (economic settlors), often recorded simply as "Foreign Money Deposit."[e] Alamieyeseigha claimed such funds were "contributions from friends and political associates towards the education of my children," which Mr. Justice Morgan would later find dubious in light of the governor's inconsistent and changing explanations.[f] Notably, this account received suspect funds of at least US$1.5 million in two 2001 deposits by Aliyu Abubakar. Those funds were immediately converted into bonds,[g] which were transferred to the portfolio holdings of the Bahamian[h] company Falcon Flights, Inc. (purchased or incorporated by the trustees of the Salo Trust, pursuant to the trust agreement[i]) in January of 2002, burying Alamieyeseigha's control over the assets within a nested corporate vehicle structure.[j]

*Note:* a. Judgment, *Nigeria v. Santolina Investment Corporation & Ors* [2007] EWHC 437 (Ch) (07 March 2007), ¶¶13 and 39. See also Judgment, Nigeria v. Santolina Investment Corporation & Ors [2007] EWHC 3053 (QB) (03 Dec 2007), ¶34(3).
b. *Nigeria v. Santolina Investment Corporation & Ors,* Case No. HC 05C 03602, Defence of the Third Defendant [Dieprey (sic) Solomon Peter Alamieyeseigha], served May 3, 2007, ¶¶10.1 and 37.
c. Id, ¶10.1.
d. Judgment, *Nigeria v. Santolina Investment Corporation & Ors* [2007] EWHC 437 (Ch) (07 March 2007), ¶39.
e. Id. , ¶¶26 and 38.
f. Judgment, *Nigeria v. Santolina Investment Corporation & Ors* [2007] EWHC 3053 (QB) (03 Dec 2007), ¶70.
g. Judgment, *Nigeria v. Santolina Investment Corporation & Ors* [2007] EWHC 437 (Ch) (07 March 2007), ¶¶26 and 28.
h. Judgment, in *Nigeria v. Santolina Investment Corporation & Ors* [2007] EWHC 3053 (QB) (03 Dec 2007).
i. *Nigeria v. Santolina Investment Corporation & Ors,* Case No. HC 05C 03602, Defence of the Third Defendant [Dieprey (sic) Solomon Peter Alamieyeseigha], served May 3, 2007, ¶10.2.
j. Judgment, *Nigeria v. Santolina Investment Corporation & Ors* [2007] EWHC 437 (Ch) (07 March 2007), ¶¶26, 28 and 38.

Investigators and prosecutors tend not to bring charges against trusts, because of the difficulty in proving their role in the crime. Instead, they prefer to concentrate on more firmly established aspects of the case. As a result, even if trusts holding illicit assets may well have been used in a given case, they may not actually be mentioned in formal charges and court documents, and consequently their misuse goes underreported. Unless a clear trail exists, with the proceeds of corruption going into a clearly identified

trust account (or unless someone involved in the scheme with knowledge of the trust misuse furnishes sufficient evidence), investigators find it difficult to acquire, through normal legal channels, even the most minimal evidence required to pursue an investigation (and gain a judgment). The extent to which the investigation and prosecution of trusts constitutes a real obstacle may depend on the jurisdiction involved. For example, in jurisdictions where trustees are regulated for AML purposes and the provision of information by such individuals to law enforcement is a well-established practice, a trust may not prove unduly problematic. As one investigator in such a jurisdiction put it, "If you've identified a trust in your investigation, you've hit the jackpot." The perception that trusts are impenetrable may not always reflect the reality of the situation.

Conversely, using trusts to conceal assets does have some potential drawbacks, which may contribute to its low incidence. Professional trustees (who are required to follow standard financial compliance practice) tend to be more inquisitive about the source of funds to be vested in a trust than they would be if establishing a company. They are inquisitive because they face the risk of exposure to legal action, either by outside parties arguing claims against the trust or trust assets, or by settlors and beneficiaries for breach of fiduciary duties. Defending the trust from a suit can prove a costly undertaking for a trustee. Consequently, professional trustees may have a stronger incentive than a company service provider[38] to avoid suspicious clients and ensure that the assets to be placed in trust are indeed owned by the settlor and are of legitimate origin. Furthermore, most service providers nowadays request proof of the source of the funds (for example, a copy of a will or a letter from an attorney for an inheritance, a receipt of sale for funds derived from property or shares, or pay slips).

### *3.2.3 Foundations*

Foundations are a form of "unowned" economic entity, in which asset contributors cede rights of ownership, control, and beneficial interest to the foundation.[39] This corporate form is often used for nonprofit and charitable undertakings. Some jurisdictions have specific laws governing foundations, notably the Liechtenstein *Anstalt* and the Panamanian Private Interest Foundation (see appendix 3). In many other jurisdictions, a foundation is merely a naming convention used for any corporate vehicle (usually a company or a trust) that is intended to benefit a cause,[40] rather than to provide a return on investment to contributors.

38. A service provider is unlikely to face such liability when establishing a company. Legal action would be taken against the assets and the beneficial owners of the company itself, rather than the provider who established the company. The service provider's liability is likely to be limited to its capacity as a nominee director. Consequently, such service providers have less incentive to determine whether or not the client is legitimate.

39. As in the case of trusts, such a cession of rights proves to be more theoretical than concrete, as in practice it may be circumvented to varying degrees by allowing the foundation's council to be composed of the asset contributors themselves (or corporate persons controlled by them) or by specifying that the object of the foundation is to financially assist the asset contributors (through wealth management or estate distribution and others).

40. This cause need not always be charitable in nature. See the discussion of the Panamanian Private Interest Foundation in appendix C.

The compliance officers interviewed for this study did not point to foundations as an area of concern, although in a small number of jurisdictions, certain banks indicated a reluctance to enter into financial relationships with foundations, largely because of a lack of familiarity with this kind of corporate entity.[41]

Roughly 13 percent of the grand corruption investigations studied involved (in aggregate) the misuse of 41 foundations, *Anstalten*, or other nonprofit corporate vehicle types that were identified as foundations in court documents. Approximately half originated in Liechtenstein, although this number was skewed by the scheme of Ferdinand and Imelda Marcos of the Philippines, which alone accounted for 15 *Anstalten*.

With the exception of the Marcos case, most of the schemes involving the misuse of foundations did not use a foundation as a shell entity to hold illicit assets, but instead purported to be operational charitable or public interest foundations. This false appearance of doing good may have been intended to discourage close scrutiny of the use of funds. In some cases, funds actually may have been used for the stated object of the foundation, but corrupt officials nonetheless were able to collect assets (especially bribe payments) into foundations and then divert funds elsewhere (see box 3.9).

### BOX 3.9 Hiding the Proceeds of Corruption in a Charitable Foundation

*The Case of Former President Joseph Estrada (Philippines)*

In 2000, Joseph Estrada, then President of the Philippines, set up the Erap Muslim Youth Foundation Inc. to "foster educational opportunities for the poor and underprivileged but deserving Muslim youth and students of the Philippines and support research and advance studies of youth Muslim educators, teachers and scientists."[a] Indeed, according to its website, the foundation had provided many scholarships for students to attend universities in the Philippines.[b] In its September 2007 decision in Estrada's Plunder case, the Sandiganbayan (the Philippines' antigraft court) held that US$4.3 million of the US$11.6 million in protection money that Estrada had collected from illegal "juteng" gambling operators were secretly deposited into the foundation's bank accounts. According to the Sandiganbayan, the protection money had initially been hidden away in secret bank accounts set up by his auditor, Yolanda Ricaforte. When Estrada came under investigation for corruption by the Philippine Congress, however, he directed that some of the funds be deposited into the account of the Erap Muslim Youth Foundation.[c]

*Note:* a. See http://muslimyouthfoundation.com/about.htm.
b. See http://muslimyouthfoundation.com/scholars.htm.
c. People of the Philippines v. Joseph Ejercito Estrada, et al., Sandiganbayan Criminal Case No. 26558 [for Plunder], September 12, 2007 Decision.

41. Dealing with nonprofit companies, however, is more standard fare for compliance officers, because such companies are considered to be a primary concern in relation to the financing of terrorism (addressed in FATF Special Recommendation 8) and the source of the contributed assets tends to be carefully scrutinized by bankers.

### 3.2.4 Fictitious Entities and Unincorporated Economic Organizations

Although all legal persons (including incorporated companies) are "fictitious" in the broadest sense, the category of corporate vehicle referred to in this subsection includes only those with the most tenuous separation of personality from their controllers: They exist *entirely* as an alternative name under which persons conduct business. The glossary of the FATF 40 recommendations clarifies that guidance given in Recommendation 33 on the need for transparency of legal persons is meant to extend beyond entities that have undergone a formal incorporation process to include "partnerships, or associations, or any similar bodies that can establish a permanent customer relationship with a financial institution or otherwise own property."

These types of fictitious entities provided opacity in a small number of the grand corruption investigations studied. The typical purposes of misuse included serving as the name of a business-class bank account (used to launder or store illicit proceeds) or as a name on a contract (for example, listed as a vendor on a government project), spiriting away funds into foreign bank accounts or putting through cash withdrawals before the fraud was discovered. The benefit of misusing these economic forms is clear: authorities are less aware of the existence of the entity,[42] while the criminals face no more liability[43] than they already were exposed to because of the illicit nature of their activities.

Some of these misused entities were originally legitimate, operational businesses that the owners then misused (see Berry Exports in Case Study 2, Charles Warwick Reid, in appendix D). Others, although devised with criminal intent, were intended to stand up to some level of scrutiny (as in the Hollis Griffin case, see box 3.10, in which the misused general partnership that was created was registered[44] with local authorities). Still others proved to be blatant falsehoods even at the most cursory of checks (for example, several cases involved nonexistent companies that were purportedly incorporated in some jurisdiction but that did not appear—even as shell companies—in any company registry[45]).

42. The legitimate benefit of conducting business through an unincorporated entity is that less bureaucratic red tape is involved—such an entity need not be "created" through official government processes.
43. The economic argument against conducting business in such a manner is that these economic forms offer no protection in law against unlimited liability. Although this is a concern that needs to be taken into account by legitimate business owners, it is less so for those whose entire purpose is criminal in nature, because criminal liability is never "limited," regardless of business form.
44. "Registration" consists of providing the business names and parties to the local authority, and it is not to be confused with "incorporation."
45. Although they did not really exist, such "companies" often received government contracts for projects that were (a) vehicles for fraud (the project authorizers never intended the project to be completed, merely using it as a cover-story for paying out funds to the corrupt contractor or recipient); (b) legitimate but never performed (funds were received but performance of the contract was either faked or never attempted); or (c) legitimate but subcontracted out to others (the recipient of the contract hired others to complete it, with the contract recipient's only involvement being to profit from a percentage of the contract value).

## BOX 3.10 Receiving Fraudulent Government Contracts by a Partnership

*The Case of Hollis Griffin, Environmental Protection Director (U.S. Virgin Islands)*

One of the only clear instances in which a general partnership was found to have been created for anonymity purposes to launder the proceeds of corruption occurred when Hollis L. Griffin, along with three other unidentified officials of the government of the U.S. Virgin Islands, authorized and awarded more than US$1.4 million in contracts, in exchange for bribes and kickbacks.[a] Less than a year after being appointed director of the U.S. Virgin Islands Department of Planning and Natural Resources (DPNR), Division of Environmental Protection,[b] Griffin and others[c] formed a fictitious business partnership and association under the name "Elite Technical Services" (Elite I).[d]

In May 2000, several of Griffin's conspirators registered Elite I with the Office of the Lieutenant Governor of the U.S. Virgin Islands under the trade name "Elite Technical Services." The Certificate for Registration of Trade Name declared the intended nature of the partnership business to be "Computer Consulting and Systems Consulting" and further contained a forged signature of another high-ranking government official, falsely stating that the official was a partner of Elite I.[e] Several months before registration, the partnership was awarded a no-bid contract by DPNR relating to a building-permit request. Without fulfilling its terms, Elite I was paid US$125,755.34, with approximately US$80,000 cash payments being delivered to Hollis and other officials.[f] Payment was received via two checks paid into a First Bank account, following which the funds were removed from the account in structured cash withdrawals.[g] After this first illicit contract was completed, the Elite I partnership was converted into a U.S. Virgin Islands corporation "Elite Technical Services, Inc." in February 2001.[h]

*Note:* a. *US v. Hollis L. Griffin*, No. 2006 cr-35 (District Court of the Virgin Islands, St Thomas & St John). Complaint. ¶16(C).
b. Id. ¶2 (3).
c. Id. These others included separately charged co-conspirators Esmond J. Modeste (President and CEO of GBS, Ltd., an accounting firm incorporated and principally conducting business in the state of Georgia [¶¶13-14]) and Earl E. Brewley (a local US Virgin Islands Fire Service firefighter and self-employed taxi driver [¶4]). Griffin, Modeste, and Brewely all pled guilty to the charges. See Press Release: US Department of Justice. "Former Government Official Is Third to Plead Guilty in $1.4 Million Virgin Islands Bribery Scandal," September 26, 2006 [Last accessed 08/20/2010: http://www.justice.gov/opa/pr/2006/September/06_crm_649.html] and were sentenced to jail time, and (fitting for a general partnership) found jointly and severally liable for US$1.1m. Press Release: US Department of Justice. "Two Virgin Islands Commissioners Convicted in $1.4 Million Bribery and Kickback Scheme." February 28, 2008.
d. Id. ¶5.
e. Id. ¶¶5-6, 17 A(2).
f. Id. ¶17 B(4),(5),(6).
g. Id. ¶17 J(1),(2). From the first check of US$43,455.34, the sum of US$33,000 was removed within nine days in four transactions of between US$7,500 and US$9,000 each, while from the second check of US$82,300, the sum of US$59,400 was removed over the course of the following two weeks, US$9,900 at a time, twice a day on three separate occasions.
h. Id. ¶7.

In some cases, access to the financial services for these types of entities was the result of dishonest collusion or negligence on the part of bankers. In other instances, the financial institutions were presented with plausible (although false or forged) evidence that justified the creation of the account and gave what was, for their purposes, a satisfactory explanation for the resulting transactions that occurred through the accounts. Most unincorporated businesses were able to open financial accounts under the protocols that banks allow for dealing with sole proprietorships, partnerships, or the "trading as" (or "doing business as") names that are often used by (natural or corporate) persons

BOX 3.11 Laundering Money through a Sole Proprietorship

*The Case of Plateau State Governor Joshua Dariye (Nigeria)*[a]

The Federal Republic of Nigeria engaged in civil asset recovery attempts in the United Kingdom in the hopes of recouping £762,000 that had found its way into the U.K. financial system from £2.6 million of Plateau State public funds that represented either misappropriated public funds or secret profits obtained by Gov. Joshua Dariye through the abuse of his position as a public officer.[b] As noted by the U.K. High Court,

> *"On or about 16 December 1999, in Nigeria, Mr. Dariye applied to the Abuja branch of Allstates Bank Pic to open an account in the name of 'Ebenezer Retnan Ventures'. Mr. Dariye signed the application form as 'Ebenezer Retnan', this name being an alias adopted by him. As he admitted to the Metropolitan Police in an interview on 2 September 2004, the Ebenezer Retnan account was his account. Mr. Dariye did not register Ebenezer Retnan Ventures with the Nigerian Corporate Affairs Commission and he requested the management of the Allstates Trust Bank Pic to waive all account-opening requirements beyond completion of the application form. The Ebenezer Retnan account was opened as account no. 2502012136 on 22 December 1999, with the first transaction taking place on 1 March 2000. Mr. Dariye used the Ebenezer Retnan account to receive large sums from Plateau State, of which he was Governor. . . . Mr. Dariye thereby transferred naira (N) 53.6 million from public funds to [the Ebenezer Retnan account]."*[c]
>
> *Nigeria's Particulars of Claim stated that Mr. Dariye "wrongfully transferred N438.6 million (about £2.6 million) from public funds to his Ebenezer Retnan account."*

*Note:* a. Particulars of Claim filed by the Government of Nigeria in Federal Republic of Nigeria v Joshua Chibi Dariye and Valentina Dariye, Claim No. 07 C00169 filed on 25 Jan 2007; "Case-study: the Dariye proceedings in the United Kingdom. Written by Case Practitioner." <Accessible at: http://www.assetrecovery.org/kc/node/4710f64d-c5fb-11dd-b3f1-fd61180437d9.html> noting that on June 7, 2007, the High Court ordered judgment in favor of Nigeria and against Dariye and his wife for US$5.7m, plus interest (totaling US$8m), affirmed as fact in Federal Republic of Nigeria v Dariye and Another [2007] EWHC 0169 (CH) 7 June 2007 Approved Judgment.
b. Federal Republic of Nigeria v Dariye and Dariye EWHC 0169 (CH), Particulars of Claim, 25 Jan 2007. ¶47
c. Id., ¶¶26-37.

engaging in trade. Generally speaking, it is not mandatory for basic information on such entities to be maintained at the state level, although there are exceptions.[46]

### *3.2.5 Other Ways to Use Corporate Vehicles to Obscure Control and Hide Money Laundering Activities*

Grand corruption schemes involving corporate vehicles often involve the use of additional strategies to add layers of "legal distance" between the corrupt beneficial owner and his

46. Nigeria's strict business naming law (see Laws of the Federal Republic of Nigeria 1990, Chapter 59, Companies and Allied Matters Act [CAMA], Part B, Section 656, Business Names) is one such example in which compelling government interest in preventing corruption has resulted in more strict information-gathering policies being implemented. If a natural or corporate person in Nigeria does business under a name other than their natural, full, legal one, it must be registered with the authorities.

assets. These multiple layers render the beneficial owner's connection to money laundering less apparent to investigation. These layers may also allow the owner to plausibly deny ownership or control of such assets if they are discovered. Investigations are particularly complicated when such layers are placed strategically in multiple jurisdictions, because no investigating authority will have the legal compulsory power to procure evidence from all parties involved. This may be accomplished in many different ways. This section discusses the two most commonly used strategies: legal fiction and the use of surrogates.

### *Separating the Beneficial Owner from Formal Control via a Legal Fiction*

In a tiered corporate vehicle structure, layers or "chains" of legal entities and/or arrangements are inserted between the individual beneficial owner(s) or controller(s) and the assets of the primary corporate vehicle. The use of tiered entities affords a beneficial owner further opportunities to pocket integral pieces of relevant legal ownership, control, and assets across multiple jurisdictional boundaries. All this makes it easier for him or her (a) to access financial institutions in the names of different entities, which serve the same ultimate end, and (b) to maintain control over the primary corporate vehicle (that is, the vehicle holding, receiving, or transferring the asset). Tiered entities enable the beneficial owner to meet these goals while remaining wholly obscured by a convolutedly indirect hierarchy.

This type of tiered approach appeared most commonly in our grand corruption database in situations in which legal entities were listed as (a) the legal shareholders or (b) the directors of companies or (c) both. When discussing such cases, the investigators we talked to said that their efforts to ascertain who truly controlled a suspect entity were frequently frustrated, especially when they were pursuing such information outside their own jurisdictions. Despite having gathered considerable information about an entity, the investigator may still not have been able to reconstruct the control framework; on the contrary, a new layer of opacity may have appeared. For example, if, as part of a money laundering investigation, the authorities in Country A manage to successfully cooperate through the appropriate formal channels with the authorities of Country B to discover the shareholders of a corporation registered in that jurisdiction, they may well find that the listed shareholders of that corporation are in fact corporations registered in Countries C and D.

It is a widely held view that corrupt officials particularly like to hide away their ill-gotten gains using corporate vehicles established in offshore centers. It is true that most of the cases reviewed did involve schemes in which corrupt officials used corporate vehicles established under laws other than their own. Offshore jurisdictions by no means have a monopoly of this type of business, however. Corporate vehicles established under what are normally considered "onshore" jurisdictions (such as the United States and the United Kingdom) also feature prominently in the database. The complex, transnational nature of some of the grand corruption schemes analyzed for this study is clearly illustrated by the case of Pavel Lazarenko of Ukraine (See box 3.5). Twelve jurisdictions were implicated, and criminal charges were filed in Ukraine and criminal convictions were obtained in Switzerland and the United States. Lazarenko and his

## BOX 3.12 "Chaining" Corporate Vehicles to Conceal Beneficial Ownership

*The Case of Former New York Senate Majority Leader Joseph L. Bruno (United States)*[a]

From 1993 to at least 2006, Joseph L. Bruno defrauded the State of New York by exploiting his position as New York senate majority leader for personal enrichment, using his ability to influence official action in return for personal benefit.[b] He also filed faulty annual financial statements about his consulting work for a company called business consultants. This company was used to disguise Bruno's identity.[c] The whole scheme was effected through several corporate vehicles. One of these was Capital Business Consultants LLC, a company incorporated by Bruno, which never performed any real function other than to serve as an alternate name for the bookkeeping of his outside financial activities.[d] The payments for fictional services actually were made out to Capital Business Consultants LLC and Business Consultants, Inc., a fictional subsidiary that never had been formally incorporated.[e] Bruno further used Capital Business Consultants LLC to "purchase"—and thus conceal—his ownership interests in Microknowledge, Inc. (a company holding contracts with the State of New York), which he and Fassler had acquired in 2000.[f]

*Note:* a. Details taken from Indictment. US v Joseph L. Bruno. (U.S. Dist. Ct., N.D.N.Y., Jan. 23, 2009) and confirmed in: Federal Bureau of Investigation, New York Field Office Press Release. "*Former New York State Senate Majority Leader Joseph L. Bruno Convicted of Scheming to Defraud the Citizens of New York of His Honest Services*," December 7, 2009. [Last accessed July 5, 2010: http://albany.fbi.gov/dojpressrel/pressrel09/alfo120709a.htm]
b. Indictment. US v Joseph L. Bruno. (U.S. Dist. Ct., N.D.N.Y., Jan. 23, 2009) ¶¶18-21.
c. Indictment. US v Joseph L. Bruno. (U.S. Dist. Ct., N.D.N.Y., Jan. 23, 2009) ¶57(b)(1)(d).
d. Indictment. US v Joseph L. Bruno. (U.S. Dist. Ct., N.D.N.Y., Jan. 23, 2009) ¶39
e. Indictment. US v Joseph L. Bruno. (U.S. Dist. Ct., N.D.N.Y., Jan. 23, 2009) ¶¶41, 43
f. Indictment. US v Joseph L. Bruno. (U.S. Dist. Ct., N.D.N.Y., Jan. 23, 2009) ¶¶46-48

associates were found or alleged to have formed corporate vehicles, held illicit proceeds, and conducted transactions in Antigua and Barbuda, Bahamas, Cyprus, Guernsey, Liechtenstein, Lithuania, Poland, the Russian Federation, Switzerland, Ukraine, the United Kingdom, and the United States.[47] Not every case, however, involves this degree of complexity. A little more than one-third of the cases we reviewed involved officials using corporate vehicles established under the laws of their primary place of residence.

The ability to chain within and across jurisdictions has few restrictions. In all countries, legal persons are allowed to own shares in companies. Additionally, in a majority of the 40 jurisdictions whose registry systems were reviewed as part of this study, legal persons may be registered as the directors of companies. Twelve jurisdictions were found to prohibit corporate directors of this sort outright, whereas five jurisdictions restrict the use of corporate directors in some way—for example, by requiring that a legal person that is a corporate director not itself have any corporate directors but only natural persons; that the corporate director be licensed; or that the corporate director not

47. US v. All Assets Held at Bank Julius Baer, et al., Case No. 1:04-CV-00798-PLF (D.D.C.). First amended verified complaint for forfeiture *in rem* (June 30, 2005).

TABLE 3.1 Two Examples in Which the Registration of Corporate Directors Is Addressed in Law

| Guernsey | Hong Kong SAR, China |
|---|---|
| An application for incorporation of a company shall be made to the Registrar, and shall include with respect to directors,[a] where a director is not an individual, the following particulars that must be entered in the register—(a) its corporate or firm name and any former such name it has had within the preceding five years; (b) its registered office (or, if it has no registered office, its principal office); (c) its legal form and the law by which it is governed; and (d), if applicable, the register in which it is entered and its registration number in that register.[b] | A person who wishes to form an incorporated company shall apply to the Registrar in the specified form, which shall contain the following particulars with respect to each person who is to be a director of the company on its incorporation, in the case of a body corporate, its corporate name and registered or principal office.[c] |

*Note:* a. The Companies (Guernsey) Law, 2008, 17(1)–(3), Application for incorporation.
b. The Companies (Guernsey) Law, 2008, 143(5), Register of directors.
c. Hong Kong Companies Ordinance, Chapter 32, §4A(2)(h) and (i), Incorporation form.

include any foreign company or trust.[48] See table 3.1 for two examples in which the registration of corporate directors is addressed in law. Additionally, in cases in which prohibitions were noted, they did not necessarily hold across all legal entity types: a jurisdiction that requires natural persons to undertake the management of one legal entity type (thus disallowing corporate directors in that role) might not do so in the case of another type.[49]

Of course, the chaining of corporate vehicles (in either ownership or control capacities) does not necessarily imply a risk of money laundering activity. The most elaborate tiered-entity ownership and control structure may still seem simple in comparison to what happens in practice in legitimate undertakings.

48. For example, in the United Kingdom, since 2008, at least one director of a legal entity must be a natural person, such that directors of an entity may not all be corporate directors. Companies Act 2006, Part 10, Paragraph 155.
49. For example, in Antigua and Barbuda, the International Business Corporations Act (IBCA), at Section 61, only requires resident natural person directors in a limited context (". . . in the case of banking, trust or insurance corporations, . . . at least one director must be a citizen and resident of Antigua and Barbuda . . . and, in the case of banking, trust or insurance corporations, all directors must be natural persons . . ."). At the same time, a corporate trustee is required for organization of a trust under the International Trust Act (ITA). An international trust is one in respect of which at least one of the trustees is either a corporation incorporated under the IBCA or a licensed trust company doing business in Antigua and Barbuda.

Neither does the chaining of corporate vehicles together necessarily obscure the beneficial ownership of a corporate vehicle. For instance, the use of corporate vehicles as owners and controllers is a common feature of government-owned and -operated corporate vehicle structures set up to engage in either public or commercial business on behalf of the state. Similarly, a family business may be an operational company whose ownership and control is vested in further companies, representing the stake of each individual family member. And a publicly traded company may be listed as the owner or controller of as many subsidiaries as allowable by law and operating agreement. In all these examples, a banker, lawyer, accountant, or other service provider can readily ascertain the true beneficial ownership of the corporate vehicle structure. These kinds of tiered entities have virtually no risk of being misused to conceal the identities of any unknown beneficial owner(s). Instead, identification of money laundering risks will depend on the reputations, intentions, and activities of the known end users and agents of the client—in other words, it will depend on where the corporate vehicle's assets come from and go to, on whose orders, and why.

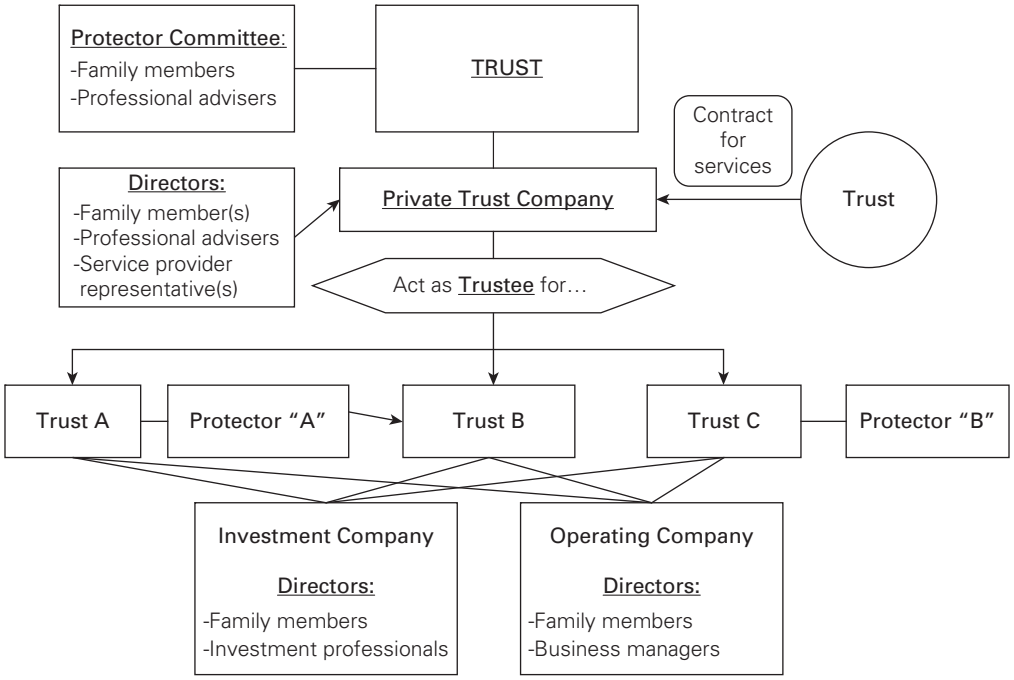
When confronted with a multilayer corporate vehicle structure, most service providers will need to ensure that they understand why such a complex structure makes sense in the circumstances. This assurance is necessary because the absence of a plausible explanation often implies a money laundering risk for economic service providers conducting business with this type of organization. As a number of compliance officers indicated, a complex corporate vehicle structure "passes the smell test" only when there are (a) legitimate business reasons to justify the form of the structure and (b) significant arguments against using less complex options that might have been available.

Excessive complexity in a corporate vehicle structure can be a good "red flag" indicator of risk—but only if one has a good grasp on what constitutes "excessive." Bankers find it difficult to explain to others exactly what excessive is in such cases: it is grasped only through years of experience. Younger, more junior staff may struggle to understand excessive complexity and miss warning signs. Conversely, investigators with limited background in corporate vehicle structures may tend to overestimate complexity; and a tendency to eye all multilayer structures with suspicion may be just as dangerous, as it can potentially result in the inefficient allocation of law enforcement resources. An example of a complex structure that is nonetheless perfectly legitimate can be seen in figure 3.1.

From our discussions with various service providers, we have distilled four good practices (see box 3.13) that will aid staff in developing a good sense of what level of complexity is appropriate and what may be suspicious.

Such measures are virtually useless, however, unless one drills down to natural persons. Compliance officers in countries where institutions are not required to identify beneficial ownership said they did not feel that they were under any obligation to pierce through layers of corporate vehicle structures when conducting due diligence

FIGURE 3.1 Example of a Complex Legitimate Corporate Vehicle Structure




*Source:* Authors' illustration based on material presented by a member of the Society of Trust and Estate Practitioners (STEP) at the STEP Caribbean Conference CC10 in Bridgetown, Barbados, May 25, 2010.
*Note:* This example of a complex corporate vehicle structure was devised by a member of the Society of Trust and Estate Practitioners (STEP). It is designed to implement perfectly legitimate goals: to provide segregated asset pools for different investment assets and different family members while ensuring that investment operations be guided by specific instructions (typically of the grantor) with the assistance of outside experts. Clearly, however, unraveling the complexity of this structure would require specific expertise.

## BOX 3.13 Developing a "Nose" for Inappropriate Complexity

Following are four good practices to develop the ability to recognize inappropriate complexity:

- **The three-layer test.** One compliance officer suggested an informal "three-layer complexity test" as a quick-and-dirty rule of thumb. Whenever more than three layers of legal entities or arrangements separate the end-user natural persons (substantive beneficial owners) from the immediate ownership or control of a bank account, this test should trigger a particularly steep burden of proof on the part of the potential client to show the legitimacy and necessity of such a complex organization before the bank will consider beginning a relationship.

*(continued next page)*

BOX 3.13 *(continued)*

- **Expert opinion.** In most legal situations, the rationale for a complex corporate vehicle structure is that it is the most economically advantageous. Often, an expert opinion will certify the legal validity and fiscal appropriateness of the structure. Compliance officers can ask for a copy of that legal opinion (and larger banks can have that opinion validated by their own legal departments).
- **Training.** Many of the bankers who took part in our study asked if the database of grand corruption investigations compiled as part of this study could be made available to them so that they could incorporate sample cases into in-house training sessions with junior staff. The time spent exposing junior staff to novel and atypical instances of corporate vehicle misuse hidden in layered complexity (from formal training sessions to the trading of war stories) is an exceptionally effective way to help investigators develop a keen nose for suspicious indicators.
- **Partnering with professional organizations.** To recognize "excessive" complexity, one needs a good understanding of day-to-day practice and the rationale underlying reasonable (that is, economically sensible and legal) complex corporate vehicle structures. To help to "demystify" the services and products of TCSPs, professional organizations, such as the Society of Trust and Estate Practitioners, are seeking active partnerships with law enforcement and other possible investigators.

in relation to clients.[50] In such cases, they said their financial institution would do no more than simply determine the legitimacy of the corporate vehicles making up the first level of ownership or management, typically by checking the validity of any customer-provided documents by searching in a company registry or using any confirmation materials that could be found online.

Corporate vehicle layering represents a significant problem for investigators. No standard rules of registration make a distinction between (a) a corporate vehicle that owns or controls another (as part of a larger, multi-vehicle structure) and (b) a corporate vehicle that is merely a professional nominee provider. In the absence of clear (or at least suggestive) evidence that a corporate vehicle falls into one or other of these categories, an investigator may find it difficult to know how to proceed. If the jurisdiction of the shareholding entity does not regulate professional nominees, it may not have an immediate way to ascertain the entity's status. If the investigator approaches the entity

50. Certain contributors to the project pointed out that the current domestic industry interpretation of beneficial ownership statutes in their jurisdiction allows for the term to be understood as a natural *or* a corporate person, despite having been implemented to address FATF Recommendation 33, which specifically references natural persons.

for information, will the service provider be cooperative—or will it tip off a participant in the scheme?

If an investigator believes that the owners or controllers of the corporate vehicle under investigation are part of some larger, multi-vehicle structure, then he or she will want to analyze the ownership and control of this larger structure, in the expectation that it will bring him or her closer to the beneficial owner(s). To that end, the investigator will seek to obtain evidence that genuinely documents the owners and controllers and the activities of this larger structure. However, if instead the investigator manages to determine that the corporate directors or shareholders are professional nominees, then he or she will give priority to finding out who contracted the nominee services. Relevant evidence will be the trust deeds, indemnification-of-agents contracts, and power-of-attorney declarations whereby the nominee(s) agreed to take legal possession of the shares or to act as the director(s) of the company in question. The investigator can check with the service providers' jurisdiction to see whether it is a regulated business. This will help the investigator decide how best to proceed.[51]

### *Separating the Beneficial Owner from Formal Control through the Use of Surrogates*

In many instances, parties to corruption have found it useful to arrange for other persons (whose names will attract less attention than their own) to be declared the party responsible for a corporate vehicle in some capacity. Out of the 150 grand corruption cases in our database, more than two-thirds involved some form of surrogate—be it in ownership or in management. The use of a surrogate is a particularly effective way of increasing the opacity of a scheme. For example, a legal entity will usually be subject to a registration regime, in which case at least information on management and control is publicly available or accessible to the authorities. The principal actor in a corruption scheme can plant evidence that leads to the surrogate and thereby conceals his or her own connection to the entity.

Most financial institutions consulted for this study said that, in cases in which they suspected that someone else was involved, they did no more than check whether the natural person wishing to enter into a business relationship with them was acting on behalf of some other person. From the names of natural persons or chained corporate vehicles, the number and identification details of directors, or even self-disclosure, it quickly becomes obvious, they say, which accounts are suspect. When pressed on this issue, certain institutions said they adopted a more consistent approach by using a jurisdiction-mandated beneficial ownership disclosure form. In such cases, the

51. If the corporate nominee is a regulated TCSP, it probably falls under AML or regulatory regimes that require the company to collect (and make available to the authorities) beneficial ownership information and identification documents, while being legally prohibited from tipping off suspects during an inquiry. If it is a TCSP from an unregulated jurisdiction, however, a more cautious approach would be warranted.

BOX 3.14 Setting up Formal Nominee Arrangements for BCP Consolidated Enterprises (Nevada)[a]

BCP Consolidated Enterprises was a Nevada corporation set up by a Nevada service provider with a nominee director (officially based in Panama) and nominee shareholders. The name of the beneficial owner appears nowhere on the incorporation documents. With the help of the service provider, BCP Consolidated then opened an online bank account with a major U.S. bank. The cost of establishing the company and the bank account was US$3,695. Neither the original service provider nor the bank required more than an unnotarized scan of the client's driver's license (which happened to show an outdated address).

*Note:* a. This was undertaken in the context of the TCSP project on company service providers.

institutions are always apprised of the beneficial owners of the corporate vehicle's accounts (unless the parties before them are prepared to perjure themselves).

Two different classes of persons actively engage in shielding the beneficial owners or controllers of a corporate vehicle from scrutiny: (a) formal nominees (acting professionally) and (b) front men (acting informally).

### *Formal Nominees*

A nominee is essentially a person who holds a position or assets *in name only* on behalf of someone else. Nominee participation in a corporate vehicle can be devised by trust (typically when holding shares) or by civil contract (typically when registering as a company director) between the nominee and the actual end user.[52] A typical example of how easily formal nominees can be arranged is shown in box 3.14.

Although the reasons for permitting nominee shareholding are apparent in the case of publicly held companies (for example, to facilitate the clearing and settlement of trades by brokers), compelling reasons in a private company context are more debatable. Suppose an individual wants to acquire complete shareholder control of a company that by statute or by law requires two shareholder members. This can, of course, be effected by incorporating a second legal entity to be that second member, or indeed by fundamentally altering the company (in terms of jurisdiction, organization, or bylaw). But it is actually often much cheaper and simpler to hire a company service provider to acquire a negligible "in name only" stake in the company. Service providers most frequently advertise nominee services as a standard component of establishing legal

52. Jack A. Blum, Esq., Prof. Michael Levi, Prof. R. Thomas Naylor, and Prof. Phil Williams, *Financial Havens, Banking Secrecy and Money Laundering* (United Nations Office for Drug Control and Crime Prevention, Global Programme Against Money Laundering, 1998), p. 30.

**BOX 3.15 The Opacity Benefits of Using Nominees**

*As Described in Typical Advertisements*

*Nominee Director Service. Who is a Nominee Director?*[a]

*A nominee director is someone who in fact is renting his or her name to you. In other words, the name of this person is used and not yours for the incorporation documents. They are also taking the positions on paper of the company directors. The term of* straw man *or* front man *has been used to describe someone who is acting as the nominee. Legally, according to the incorporation documents, the nominee is responsible for the company or entity. In addition, if it is the case of a nominee that is also listed as the nominee shareholder, then they in effect also have the related ownership responsibilities as well.*

*The basic function of the nominee director is to shield working executives of limited and other companies from the public disclosure requirements that exist in the UK and other jurisdictions. It is a perfectly legal device, which preserves the privacy of an individual. It is designed to help a person who would rather not disclose their interest or association with a given corporate body. Anyone performing a company search on a company with a nominee director would be unable to discover in whose name the nominee director was registered.*

*Note:* a. See http://www.ukincorp.co.uk/s-23-uk-nominee-director-advantages.html.

entities, as a way to ensure that the names of the entity's true owners are nowhere to be found on the entity's paper record, thus ensuring privacy. For examples benefits typically cited in advertisements, see box 3.15.

All the national jurisdictions examined for the purposes of this study either explicitly allowed or did not expressly prohibit nominee participation in a legal entity. Guernsey was the only jurisdiction that directly addressed the fact that persons other than those occupying the declared legal management roles of a company may in reality be controlling its activities (although Hong Kong SAR, China, has a provision that perhaps could be interpreted as addressing this matter).[53] See table 3.2 for two examples in which the registration of nominees is addressed in law.

53. *The Companies (Guernsey) Law, 2008, § 132:* "(1) In this Law, 'shadow director', in relation to a company, means a person in accordance with whose directions or instructions the directors of the company are accustomed to act. (2) A person is not to be regarded as a shadow director by reason only that the directors act on advice given by him in a professional capacity. (3) For the purposes of sections 160 and 162 to 166, a shadow director is treated as a director." *Hong Kong Companies Ordinance, § 53(B):* "(1) Where the articles of a company authorize a director to appoint an alternate director to act in his place, then, unless the articles contain any provision to the contrary, whether express or implied: (a) an alternate director so appointed shall be deemed to be the agent of the director who appoints him; and (b) a director

TABLE 3.2 Examples in Which Nominees Are Addressed in Law

| Turks and Caicos Islands | Cyprus |
|---|---|
| *Section 4: Nominee or trust firms, etc*: "Where a firm, individual or corporation having a place of business in the Islands carries on the business wholly or mainly as a nominee or trustee of or another person, or other persons, or another corporation, or acts as a general agent for any foreign firm, the first-mentioned firm, individual or corporation shall be registered in manner provided by this Ordinance, and in addition to the other particulars required to be furnished and registered, there shall be furnished and registered in the Schedule to this Ordinance [. . .]<br>*Schedule (Section 4)*: The present Christian or fore name and surname, any former name, nationality, and if that nationality is not the nationality of origin, the nationality of origin, and usual residence or, as the case may be, the corporate name of every person, or corporation on whose behalf the business is carried on: Provided that if the business is carried on under any trust and any of the beneficiaries are a class of children or other persons, a description of the class shall be sufficient."[a] | 53(1) Where a firm, individual or corporation is required by paragraph (d) of section 50 to be registered, such registration shall be effected by sending or delivering to the Registrar, within one month of the data the business therein provided has commenced, a statement in writing, in the prescribed form, signed by all the partners of the firm or the individual or corporation, as the case may be, and containing the following particulars, that is to say, the present Christian name or names and surname, any former Christian name or names and surname, nationality and usual residence or, as the case may be, the corporate name, of every person or corporation on whose behalf the business is carried on:<br>Provided that if the business is carried on under any trust and any of the beneficiaries are a class of children or other persons, a description of the class shall be sufficient.<br>53(2) The particulars required to be furnished and registered under subsection (1) shall be in addition to any other particulars required under this Law to be furnished and registered.[b] |

a. Turks and Caicos Islands, Business Names (Registration) Ordinance, §4. Nominees or trust firms, etc and Schedule (§4), available at http://www.tcifsc.tc/Templates/Legislations/Business%20Names%20(Registration)%20Ordinance.pdf (last accessed August 17, 2011).
b. Partnership and Business Names Law, 53(1) and (2), Particulars of registration in case of nominees or trustees.

The grand corruption investigations analyzed for this study show the regular use of professional surrogates in corruption schemes. Often, these were TCSP companies specializing in offering nominees and trustee services; lawyers were also found to fulfill such roles. The consequence of such nominees being registered as a corporate vehicle's owners and controllers is that the identities of the beneficial owners remain concealed.

who appoints an alternate director shall be vicariously liable for any tort committed by the alternate director while acting in the capacity of alternate director." The Hong Kong SAR, China, provision may work in reverse of the Guernsey provision on shadow directors. In schemes in which a TCSP director hands over control to a bad actor through a power of attorney or other means, the potential exists that both parties incur liability on the basis of the bad actor's actions.

### *"Front Men"*

Unlike a hired nominee, a front man cannot be said to be just renting his name to an enterprise. Hired nominees acting in a professional capacity may be selected at random, based on cost and the level of secrecy offered. They will seek to insulate themselves by plausible deniability and indemnification agreements. By contrast, a front man is specifically selected, is more likely to be connected to the principal by biographical data than by a contractual paper trail, and usually purports to be the beneficial owner of the corporate vehicle (until legal proceedings are brought against it or the front men). The personal links between the front man and the beneficial owner may be very varied (see box 3.16).

Barring the existence of any exculpatory evidence that proves otherwise, front men face all the risks and liabilities associated with being the true end-user parties in relation to a corporate vehicle, even though they may be doing so for another person. Nearly half of the grand corruption investigations reviewed for this study involved the use of these informal front men. Typically, they appear when the corrupt party holds some public office: he will place the rights to his illicit-asset-holding corporate vehicles in the name of trusted associates or family members (see box 3.17).

One of the ways in which financial institutions are required to identify possible front men is by conducting enhanced due diligence on politically exposed persons (PEPs) *and their family members and close associates* (FATF Recommendation 6). The latter addition was included precisely to identify people in the corrupt person's circle who may be fronting for him or her. Experience shows that, in practice, it is difficult for

**BOX 3.16 Finding the Front Men: An Insider's View**

*My experience has taught me that these individuals generally have known someone in the criminal organization for a long period of time, often from school days. There is a strong bond, and the element of trust, between the front man and the criminal, [which are] often reinforced by large and continuing payments and an understanding that the front man will derive financial independence from the arrangement. I have actually looked at high-school yearbooks, and real-estate block records, in order to ascertain who were childhood friends, and/or living in the same neighborhood, as criminal targets. When I was a money launderer, I lived near a major client, which facilitated late-night meetings.*[a]

*Source:* Kenneth Rijock, "From a Different Angle: Money Laundering through Securities and Investments," March 31, 2010, http://www.world-check.com/articles/2010/03/31/money laundering-through-securities-and-investment.
*Note:* a. This quote, taken from Rijock, a World-Check financial crime consultant, speaks to the people that we include in this section under our working definition of front men.

## BOX 3.17 The Control of Corporate Vehicles by a Front Man

*The Case of Former President Augusto Pinochet (Chile)*[a]

Former Chilean president Augusto Pinochet funneled illicit proceeds through foreign corporate vehicles that named his family members and other close associates as the owners and controllers. For instance, Meritor Investments Ltd., Redwing Holdings, and a trust numbered MT-4964 were foreign corporate vehicles beneficially owned by Pinochet's son, Marco Antonio Pinochet Hiriart and his daughter Ines Lucia Pinochet. Bank accounts were also opened under the names of these two persons, as well as another daughter of Pinochet, Maria Veronica Pinochet. Oscar Custodio Aitken Lavancy, an attorney who had ties to Pinochet, controlled six other corporate vehicles involved in the scheme. Pinochet's family members and Aitken effectively served as front men for Pinochet, allowing him to disassociate his name from the scheme while maintaining control over the assets.

*Note:* a. Facts confirmed in U.S. Senate Committee on Governmental Affairs, Permanent Subcommittee on Investigations, "Money Laundering and Foreign Corruption: Enforcement and Effectiveness of the Patriot Act, Case Study Involving Riggs Bank," Report prepared by the Minority Staff of the Permanent Subcommittee on Investigations (July 15, 2004), available at http://hsgac.senate.gov/public/files/ACF58.pdf (last accessed August 14, 2011).

compliance officers to identify all family members.[54] Commercially available databases may help an institution identify a public official, but it is much harder to find out who belongs to this "circle of trust."

Investigators consulted as part of this study indicated a preference for policies that make corrupt persons more likely to turn to front men for help than professional service providers. A front man cannot hide behind bank secrecy laws or professional privilege because he is ostensibly conducting his own business. As a result, they find that front men usually give up, confess, and cooperate when the police come after them. "It's not like they're under a Mafia code," as one investigator put it. If an investigator wishes to build a case against the ultimate head of a money laundering conspiracy, then catching a front man is an effective move, because it provides the investigator with an informant who can identify the main perpetrator and assist in building the case against him. When family members and close associates own the shares (or perform the management duties) in a network of money laundering companies, it is easier to make a case that the corrupt individual is the "common thread" between all such parties; and when (as is often the case) the beneficiaries are the corrupt individual's spouse and children, it again makes it harder for the corrupt person to argue that he has no connection to the vehicle.

54. For further discussion of the point, see Theodore S. Greenberg, Larissa Gray, Delphine Schantz, Carolin Gardner, and Michael Latham, *Politically Exposed Persons: Preventive Measures for the Banking Sector* (Washington, DC: World Bank, 2010).

## BOX 3.18 The Experience of the United States

The United States is one of the world's preeminent providers of corporate vehicles to both domestic and foreign beneficial owners. As such, the strength of its AML regime is of critical importance in the global efforts to counter the misuse of corporate vehicles.

As described in the introduction to this report, concerns in the United States about the misuse of corporate vehicles formed in jurisdictions off its shores can be traced back to a 1937 report by then–Treasury Secretary Henry Morgenthau, Jr. to President Franklin D. Roosevelt. Nearly 70 years later, Secretary Morgenthau's son, then–District Attorney for New York County Robert Morgenthau would endorse U.S. Senate Bill 569, "Incorporation Transparency and Law Enforcement Assistance Act."[a] The key difference, however, was that this proposed legislation (S.569) sought to address the increasing problem of misuse of corporate vehicles formed *within* U.S. borders.

The U.S. Government's National Money Laundering Strategy calls for increased transparency of beneficial owners of legal entities.[b] A 2006 report by the Financial Crimes Enforcement Network of the U.S. Treasury examined the role of domestic shell companies in financial crimes and money laundering.[c] The Government Accountability Office, the auditing arm of the U.S. Congress, also issued reports on the misuse of domestically formed companies for money laundering, and the lack of beneficial ownership information collected by virtually all of the corporate registries operated by the fifty U.S. states.[d]

The Senate Permanent Subcommittee on Investigations, chaired by Sen. Carl Levin, held hearings on the issue in 2006, and the Senate Homeland Security and Governmental Affairs Committee held hearings on S. 569 in 2009. District Attorney Morgenthau and representatives from the U.S. Department of Justice and Department of Homeland Security's Immigration and Customs Enforcement testified that the bill had the support of U.S. law enforcement.[e] A common theme in their testimonies was that the lack of beneficial ownership information collected and held by state corporate registries impeded their investigations as well as their ability to respond to requests for investigative assistance by foreign law enforcement agencies.

Corporate registries in the U.S. typically come under the purview of each state's Secretary of State. At the June 2009 hearings, the National Association of Secretaries of State (NASS), represented by the co-chair of the Company Formation Task Force testified, "NASS and a number of other prominent organizations are currently on record in opposition to this bill, including: the Uniform Law Commissioners, the American Bar Association (ABA), and the National Conference of State Legislatures (NCSL)."[f] The opposition by NASS centered around what it described as the bill's effort to move corporate registries beyond their current ministerial role and the financial costs that states would have to bear to implement the bill's record-collection and record-keeping obligations.

The United States has no legal requirement that companies be formed through a company service provider. Individuals may form and register companies on their own. Moreover, U.S. Trust and Company Service Providers—including attorneys, accountants, and other professionals who perform such services — are not

*(continued next page)*

BOX 3.18 *(continued)*

considered covered entities under the U.S. AML regime, subject to such requirements as client due diligence and suspicious activity reporting beyond what is already required under criminal law. The ABA, in particular, has been a strong opponent of efforts, including by the Financial Action Task Force's Gatekeeper Initiative, to impose AML regulations on lawyers. Instead, in 2010, the ABA issued a "Voluntary Good Practices Guidance for Lawyers to Detect and Combat Money Laundering and Terrorist Financing."[g]

S. 569, which did not pass in the 111th Congress, was reintroduced in the 112th Congress, in August 2011.[h]

*Notes:* a. Robert M. Morgenthau, "Tax Evasion Nation," The American Interest Online, September-October 2008, available at http://www.the-american-interest.com/article-bd.cfm?piece=465 (last accessed on July 20, 2011); Written testimony by the Honorable Robert M. Morgenthau, District Attorney for New York County, Delivered by Assistant District Attorney Adam S. Kaufmann, Chief of Investigation Division Central, New York County District Attorney's Office, before the United States Senate Committee on Homeland Security and Governmental Affairs, Permanent Subcommittee on Investigations (Washington, D.C., June 18, 2009), http://www.the-american-interest.com/article-bd.cfm?piece=465. The text of S. 569 can be accessed at the website of the U.S. Library of Congress at http://thomas.loc.gov/cgi-bin/query/z?c111:S.569:, last accessed on July 20, 2011).
b. U.S. 2007 Money Laundering Strategy, available at http://fincen.gov/news_room/rp/files/nmls_2007.pdf, at 8 (last accessed on July 20, 2011).
c. U.S. Department of Treasury, Financial Crimes Enforcement Network, "The Role of Domestic Shell Companies in Financial Crime and Money Laundering: Limited Liability Companies," available at http://www.fincen.gov/news_room/rp/files/LLCAssessment_FINAL.pdf (last accessed on July 20, 2011).
d. Government Accountability Office, "Company Formations: Minimal Ownership Information Is Collected and Available" (GAO-06-376, April 2006), accessed at http://www.gao.gov/new.items/d06376.pdf (last accessed on July 20, 2011); "Suspicious Banking Activities: Possible Money Laundering by U.S. Corporations Formed for Russian Entities" (GAO-01-120, October 2000), accessed at http://www.gao.gov/new.items/d01120.pdf (last accessed on July 20, 2011).
e. Testimonies of Mr. Morgenthau (delivered by Adam Kaufmann), Jennifer Shasky Calvery (Department of Justice), and Janice Ayala (Department of Homeland Security) available at http://hsgac.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=ef10e125-2c1d-4344-baf1-07f6061611c1 (last accessed on July 20, 2011).
f. Testimony of the Honorable Elaine F. Marshall, Secretary of State, State of North Carolina and Co-chair, National Association of Secretaries of State (NASS) Committee Formation Task Force, available at http://hsgac.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=ef10e125-2c1d-4344-baf1-07f6061611c1 (last accessed on July 20, 2011).
g. Various Committees of the American Bar Association, "Voluntary Good Practices Guidance for Lawyers to Detect and Combat Money Laundering and Terrorist Financing," April 23, 2010, available at http://www.acrel.org/Documents/PublicDocuments/voluntary%20good%20practices%20guidance%20final%2009142010.pdf (last accessed on July 20, 2011). See also, Statement of Kevin L. Shepherd, Member, Task Force on Gatekeeper Regulation and the Profession, on behalf of the American Bar Association, before the Senate Committee on Homeland Security, on S. 569, November 5, 2009, available at http://hsgac.senate.gov/public/index.cfm?FuseAction=Search.Home&site=hsgac&num=10&filter=0&q=kevin+shepherd (last accessed on July 20, 2011).
h. Summary and text of the bill, "Incorporation Transparency and Law Enforcement Act," available at http://levin.senate.gov/newsroom/press/release/summary-of-the-incorporation-transparency-and-law-enforcement-assistance-act.

## 3.3 Conclusion and Recommendations

Corporate vehicles, of whatever form, are an essential part of the economy. They are the instruments through which individuals choose to invest or run an enterprise, manage wealth or pass it on to their children and collect funds for charitable activity. As with any instrument, the use that is made of them depends on the person using them. In the overwhelming majority of cases, this use will be legal, but corporate vehicles can also be used for illegal ends. It is that very small proportion of cases that concerns us here. We draw the following conclusions:

- In cases where the ownership information was available, most cases of large-scale corruption involve the use of one or more corporate vehicles to conceal beneficial ownership.

- The precise patterns of misuse vary from country to country, although the corporate vehicle most commonly used globally is the company.
- Shelf companies pose a particular problem, as they provide criminally inclined individuals with a company history and set of company officials, all entirely unrelated to the corrupt individual.
- Most companies used to conceal beneficial ownership are non-operational, although operational companies are also used, particularly for paying bribes.
- The use of professional nominees and front men increases the lack of transparency of corporate vehicle structures.
- Bearer shares, although still used to conceal beneficial ownership, are being used less frequently than they were in the past.
- A tiered structure of corporate vehicles owning or controlling others can be particularly effective in hiding beneficial ownership. Information about the beneficial owner will be either unavailable or accessible only at a specific location. Bits of information will need to be pieced together from different sources in different jurisdictions. This significantly increases the cost, time, and risk of achieving a successful outcome in a corruption investigation.
- To be able to identify suspicious, economically unsound structures, law enforcement needs to understand the rationale behind legitimate structures. At the moment, law enforcement's understanding of corporate law is limited.

On the basis of our examination of the use of corporate vehicles to conceal beneficial ownership, we make five specific recommendations:

**Recommendation 1. Jurisdictions should perform a systematic risk analysis of the cases in which corporate vehicles are being used for criminal purposes within their jurisdiction, to determine typologies that indicate a heightened risk**.

This risk analysis—identifying the risk associated with types of entities, specific jurisdictions, specific service providers, and so on—should inform the guidance provided by the authorities to those dealing with corporate vehicles on a daily basis (whether investigating them or providing services) so that they become aware of possible misuse and are better able to assess the risks.[a]

**Recommendation 2. Countries should attempt to develop a consensus definition as to what constitutes a shelf company, and should take measures to render this type of company more visible to the authorities and less desirable to illicit actors.**

Given that the time and effort required to incorporate a company have been reduced substantially in all relevant jurisdictions, the legitimate advantages of having shelf companies available have all but disappeared. Fraud risks are highest with those shelf companies that are "aged," as they give a false sense of continued existence. Countries should attempt to identify shelf-type companies incorporated under their laws and pinpoint them as higher risk (for example, through irregular business activity, such as unexplained simultaneous changes in key

positions or prolonged periods of no account activity). It will probably not be possible to prohibit the trade in shelf companies as such, because it is essentially merely the transfer of shares in a company.

**Recommendation 3. Jurisdictions should require that registered members of a legal entity disclose (be it in documents disclosed to the registry or held by the registered agent) whether they are acting on their own behalf or in the interests of another, undisclosed beneficial owner. A "Declaration of Beneficial Ownership," made by the client to a financial institution or service provider, is a useful tool to identify the possible involvement of hidden beneficial owners and should be required universally.**

By taking this small step, authorities will be able to determine at a glance whether a listed member of a legal entity is a nominee.

For a more thorough discussion on the benefits of beneficial ownership declaration forms, we refer to the Stolen Asset Recovery (StAR) publication *Politically Exposed Persons: Preventive Measures for the Banking Sector*.[b] Jurisdictions may consider requiring such a form to be kept on file with their registrar, a licensed TCSP, or domestically registered agent of the legal entity. This would mean that the jurisdiction would need to have developed a clear formal definition of beneficial ownership for the vehicle type. Such a declaration could not, of course, be seen as providing conclusive evidence of the identity of the substantive beneficial owner.

**Recommendation 4. Countries that have not taken measures to immobilize, dematerialize, or abolish bearer shares (and share warrants) should do so.**

For most countries, the initial rationale for the use of bearer shares is no longer valid, and consequently the abolition or dematerialization would not cause any adverse economic consequences.

**Recommendation 5. Countries should develop a platform to bring together law enforcement and TCSPs to serve as a framework within which relevant service providers and specialized units in law enforcement can be educated on the types of corporate vehicles and constructions used, and the rationale for them.**

This framework would help investigators and service providers to distinguish more easily between what is and what is not suspicious. It also would help to dissipate the deep distrust of the TCSP sector that is common among law enforcement.[c]

*Note:* a. Although such responsibilities should be extended to all service providers, the financial sector's responsibilities concerning high-value and PEP financial accounts—even specifically addressing corporate vehicles—are already enshrined in the United Nations Convention against Corruption (UNCAC), Article 52 ("Prevention and detection of transfers of proceeds of crime") at 2(a): "[State Parties shall] *Issue advisories regarding the types of natural or legal person to whose accounts financial institutions within its jurisdiction will be expected to apply enhanced scrutiny, the types of accounts and transactions to which to pay particular attention and appropriate account-opening, maintenance and record-keeping measures to take concerning such accounts.*"

b. Theodore S. Greenberg, Larissa Gray, Delphine Schantz, Carolin Gardner, and Michael Latham, *Politically Exposed Persons: Preventive Measures for the Banking Sector* (Washington, DC: World Bank, 2010). pp. 35–39. This report provides particularly instructive advice on the ways in which beneficial ownerships forms give service providers a benchmark against which to test subsequent (financial) conduct of an accepted customer as well as incontrovertible evidence of a customer's statements in criminal and civil proceedings.

c. In many criminal cases, investigators tend to regard TCSPs, as a group, not as neutral service providers but as parties who are at least negligent in the conduct of their due diligence and at worst complicit in criminal behavior.