

OFFICE OF NATIONAL DRUG AND MONEY LAUNDERING CONTROL POLICY
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BENEFICIAL OWNERSHIP OF LEGAL ENTITIES

TYOLOGIES ON THE MISUSE OF LEGAL
PERSONS AND ARRANGEMENTS

INTRODUCTION

FATF Recommendations 24 and 25 require that legal persons and arrangements are prevented from misuse for money laundering or terrorist financing and that information on their beneficial ownership is available to competent authorities without impediments. Heightened risks can arise with respect to beneficial owners of accounts because nominal account holders can enable individuals and business entities to conceal the identity of the true owner of assets or property derived from or associated with criminal activity. Moreover, criminals, money launderers, tax evaders, and terrorists may exploit the privacy and confidentiality surrounding some business entities, including shell companies and other vehicles designed to conceal the nature and purpose of illicit transactions and the identities of the persons associated with them. Consequently, identifying the beneficial owner(s) of some legal entities may be challenging, as the characteristics of these entities often effectively shield the legal identity of the owner. However, such identification may be important in detecting suspicious activity and in providing useful information to law enforcement.

The Office of National Drug and Money Laundering Control Policy (ONDCP) reviewed its law enforcement and financial intelligence databases as well as other international publications and has identified key methods that have been utilized to conceal beneficial ownership. These include: complex ownership and control structures, use of professional intermediaries, shell and front companies, false contracts and invoicing. Illustrations from these cases have been sanitized and used to formulate this typology document to assist regulated entities and other stakeholders in identifying fact patterns that may be indicative of illicit financial activity to detect and deter the exploitation of legal persons and legal arrangements for money laundering, terrorist financing and other criminal purposes. However, these typologies do not provide an exhaustive list of such circumstances, and stakeholders should continue to assess customer risk and identify suspicious transactions and activities in accordance with their legislative and regulatory obligations.

USE OF COMPLEX OWNERSHIP AND CONTROL STRUCTURES

Complex ownership structures are the primary method of concealing beneficial ownership for money laundering purposes. These intricate structures are developed by creating layers of possession that involve various legal persons across numerous jurisdictions, disassociating the beneficial owner from the assets owned by the corporation. Commonly, intermediaries are used by the beneficial owners to retain control of a complex structure. Legal persons are permitted to possess shares in companies set up in any country and many countries allow legal persons to be enlisted as directors of organizations. In this regard, shell organizations and front organizations are a common component in most complex structures. These structures can be utilized to cloud beneficial ownership, evade tax collection commitments, disguise wealth, and launder criminal proceeds. Complex structures are utilized in fake investment plans, phony company activity, bogus invoicing, and different kinds of fraudulent activities. The utilization of various legal persons inside an individual structure and the use of various bank accounts and nominees can fundamentally weaken endeavours by financial institutions, law enforcement, and other authorities to identify and confirm the beneficial owner.

CASE STUDY 1 – COMPLEX STRUCTURE

The accused, Mr. X, bought a bank A and set up the ownership of bank A by company B. Company B was owned by Companies B1, B2, and B3. Company B1 was owned by Mr. Y, one of Mr. X's business partners; Company B2 was owned by two other individuals; Company B3 was majority owned by Mr. Z who was Mr. X's accomplice and Mr. X, whose shares were voted by his nominee.

Mr. X incorporated a number of IBCs which became customers of Bank A. Accounts of the IBCs were held by nominees of Mr. X. Through these companies, Mr. X inserted the proceeds of corruption into the Bank A.

Mr. X exerted control over Company B3 and ultimately Bank A through Mr. Z who acted on instructions from Mr. X and also acted as a nominee for Mr. X's shares of company B3. He also ensured that a particular official of Bank A was assigned to dealing with transactions of the IBCs and facilitating the laundering.

When asked about the ownership of the bank, the regulator was at first only able to identify the ownership as held by Company B. It would take much investigation to uncover the layers that shrouded the beneficial ownership structure. A total of approximately US\$50 million was forfeited in connection with Mr. X's corrupt activities.

PROFESSIONAL INTERMEDIARIES

Professional intermediaries have been utilized by criminal organisations as they possess specialised skills or expertise which are critical to laundering funds. They specialise in the provision of services, which can also be performed while acting in a legitimate, professional occupation. These services can include, but are not limited to, the following: accounting services, financial or legal advice, and the formation of companies and legal arrangements. Some of these individuals may be complicit and may also use specialised knowledge and expertise to exploit legal loopholes, find opportunities for criminals, and help criminals retain and legitimise the proceeds of crime.

CASE STUDY 2 – PROFESSIONAL INTERMEDIARIES

Mr. T is an attorney at a local law firm who is responsible for the establishment and management of escrow accounts for the firm's clients. Mr. T incorporates the entity account for FGH Ltd. and sets up an escrow account in the entity's name. Wire transfers are then received by the law firm for credit to FGH Ltd's escrow account. Contracts and invoices provided indicated that the funds were for investment purposes. Over a three-year period, Mr. T received and disbursed funds of over US\$2 million through FGH Ltd's escrow account. Funds were used primarily for the acquisition of real estate, the establishment of bank accounts at other financial institutions and to make payment to entities with no obvious connection to FGH Ltd. No SARs were filed by Mr. T or his law firm.

During an international narcotics investigation, records from a local bank revealed transactions originating from Mr. T's law firm on behalf of their client, FGH Ltd. It was later uncovered that the beneficial owner of FGH Ltd was a member of the drug syndicate who had contracted Mr. T to obfuscate his illicit activities and proceeds.

CASE STUDY 3 – PROFESSIONAL INTERMEDIARIES

Harry Hill recently qualified to practise as an attorney and established the law firm registered as Harry Hill Chambers less than one year ago. He is the sole attorney engaged at this firm. Within a few months, Hill incorporated the business 5H Ltd. which is purportedly engaged in the manufacture and sale of prefabricated houses. The director and majority shareholder of 5H Ltd. is local businessman, Teddy Simon, who has established a good reputation in the construction industry. Soon thereafter, Harry Hill Chambers begins to receive large cheque payments from local businesses for the purpose of investing in 5H Ltd. These investments were supported by contracts which Harry Hill presented to his bank. Over a 6-month period, Harry Hill Chambers received over US\$6million in payments from various investors, which he transferred to 5H Ltd.

In a separate matter, investigators were looking into large amounts of cash that was being deposited by various businesses. Investigations revealed that these business accounts were being used as throughputs and that the cash deposited was being transferred to a third party, Harry Hill Chambers. The same funds ended up in the account of 5H Ltd and were ultimately used to purchase luxury properties and other high value items. No transactions in relation to manufacturing activity was observed on the account of 5H Ltd.

At the climax of the investigation, it was discovered that that Harry Hill was a key player in a money laundering operation and created the fictitious investment contracts to facilitate the layering of funds. In addition, it was uncovered that 5H Ltd. was controlled by an organized crime group and that Teddy Simon was being paid for the use of his name as director and shareholder.

SHELL COMPANIES

The 2014 FATF Guidance on Transparency and Beneficial Ownership defines shell companies as “companies that are incorporated, but which have no significant operations or related assets”. Shell companies are the most widely recognized kind of legal person utilized in plans and structures intended to conceal beneficial ownership. Shell companies can be utilized in complex structures including the appropriation of resources across various organizations in numerous locales. At the point when these structures are utilized for unlawful purposes, cash may be transferred through different layers of shell companies before finally being removed in real money or moved to its last destination internationally. Shell companies may register under the same procedures as any other company, and some attributes may demonstrate that a company is a shell, including the utilization of just a post-box address, an absence of employees, and non-payment of taxes.

CASE STUDY 4 – SHELL COMPANY

Mr. X incorporated six shell companies in Jurisdiction Y and used the bank accounts of these companies to launder proceeds of crime of more than 1 billion GBP. The chargeable offence was illegal earnings. The six shell companies all had a single shared nominee shareholder.

FRONT COMPANY

Front companies are fully functioning companies with assets, income, expenses, and such other characteristics associated with the operations of businesses. Often, the ostensible business activities are not the primary business or business of interest as can often be seen in that the owners do not run the business properly and often are not particularly concerned that the business is not doing well or that it is losing money, and may allow the business to go bust when it could easily have been saved. The real concern is the underlying or hidden transactions that relate to money laundering and its facilitation. The most widely recognized types of front organizations are ones operating in cash intensive sectors (retail or service businesses such as pharmacies, restaurants, bars, nightclubs, supermarkets or convenience stores, used car dealers and vehicle rentals), so that they may directly deal in money. Front organizations can be misused to make illegal money appear legitimate by claiming that the laundered money is owed to them through routine business dealings that are difficult to record and track.

CASE STUDY 5 – FRONT COMPANY

A drug syndicate based in a foreign country laundered proceeds from its cocaine trafficking operations through a local retail store. Using the owner of the store's Power of Attorney, a local member of the organized crime group, structured daily large cash deposits to the business' bank accounts and the illicit proceeds were recorded as income. A Suspicious Activity Report (SAR) was filed with the FIU based on the frequency and accumulated value of the deposits which appeared excessive for the type of business and was not consistent with the expected earnings of the business. On analysis, it was discovered that the account was being used as a throughput with the funds ultimately being for the acquisition of real estate for one of the syndicate's leaders.

CASE STUDY 6– FRONT COMPANY

An account was established at XYZ Bank for a local commercial goods supplier, LMN. Mr. A and Mrs. B are on record as shareholders of LMN and sole signatories on the business account held at XYZ Bank. LMN provides services to various public entities, payments for which are made through the account at XYZ Bank. On reviewing the account, the Bank recognizes that payments are being used solely to service debts of a local politically exposed person (PEP) who is connected to the public entities that are serviced by LMN. A SAR is filed on the basis that LMN is being used as a front and is being used to facilitate corrupt payments. On further analysis, the transactions were linked to insider dealing.

CASE STUDY 7- FRONT COMPANY

Sherry Knight is a local businesswoman who owns several cash-based businesses. The business accounts generally operated in overdraft as Knight is known to mismanage company funds. Suddenly, Knight's bank account activity showed an increase in frequent, large cash deposits. Soon after the deposits are made, the funds are paid to an intermediary purportedly for investment. Knight's bank account remains in overdraft, however, investments continue to be made with the cash deposited. Knight provides contracts substantiating the investment, however, no investment returns are visible on her account.

On investigation, it was revealed that Knight's businesses were being controlled by a weapons dealer whose interest in these entities was not disclosed. The investment being financed by Knight formed part of the dealer's scheme to launder and legitimize the illicit proceeds.

RED FLAGS

While all indicators have not been fully illustrated above as cases have been sanitized, all relevant stakeholders should consider following red flags indicating misuse of Legal Persons and Legal Arrangements:

- Use of complex ownership and control structures to obscure beneficial ownership.
- Use of specialists or professional intermediaries to facilitate schemes designed to disguise beneficial ownership.
- Using legal entities as a front entity with little underlying operations for laundering illicit finance.
- Mismatched business profile with unusual transaction behaviour or activity.
- Large cash deposits and withdrawals with dubious underlying operations.
- Structuring of transactions with mismatch between transactions and nature of business.
- Pass-through nature of the transactions.
- Funds transfers between companies with seemingly unrelated business profile.
- Transactions involving companies with no physical presence and an inability to obtain information via direct inquiries, internet or commercial database searches.
- High turn-over of funds within a relatively short period of time without any plausible explanations.
- Unclear relationships between 'connected or associated' companies and/or persons.
- Frequent/multiple transaction involving entities with the same beneficial owner which did not make economic sense.
- Inability to establish relationship between the beneficial owner and authorized signatory of the company.
- Adverse information relating to the entity and/or its management.
- The investments are not in line with the net worth of the client.

RECOMMENDATIONS AND BEST PRACTICES

Financial institutions should consider the following recommendations to improve the detection of the misuse of legal entities.

- Perform due diligence to understand if the purported nature of business is aligned to the customer's business including understanding the corporate structure and ownership.
- Obtain corroborative evidence for the underlying transactions, where transactions are not in line with commonly observed transactions and industry practice to confirm the veracity of customer's declaration.
- Using a risk-based approach, obtain information about customer at on-boarding and during ongoing monitoring of customer while considering publicly available information from relevant authorities.
- Implement systems that enable the review transaction behaviour of related entities in a holistic manner to evaluate the reasonableness of transactions.
- Understand the rationale for the appointment of authorised signatories, where they appear to be unrelated to the company's business operations or ownership.

Updated guidance on Transparency of Beneficial Ownership can be found in the Money Laundering and Financing of Terrorism Guidelines (March, 2024).