



Understanding the Role of Shell Companies in Money Laundering (ML)

CFATF RESEARCH DESK
NOVEMBER 17TH, 2022.



What is a Shell Company?

Sources:

(1) - FATF - Egmont Group (2018), Concealment of Beneficial Ownership, FATF, Paris, France, p.5.

(2) - <https://www.transparency.org/en/corruptionary/shell-company>

(3) - Ibid

(4) - Ibid

- A legal or incorporated company with no independent operations, significant assets, ongoing business activities, or employees.¹
- A company or corporation is a limited liability entity having no physical presence in a jurisdiction, no employees and no commercial activity.²
- It is usually formed in a tax haven or secrecy jurisdiction and its main or sole purpose is to insulate the real beneficial owner from taxes, disclosure or both.³
- Shell companies can include international business companies, personal investment companies, front companies, or "mailbox"/ "letterbox" companies.⁴



Legitimate Uses for Shell Companies⁵

Sources:

(5) - van der Does de Willebois, Emile, Emily Halter, Robert A. Harrison and Ji Won Park. (2011). *The Puppet Masters: How the Corrupt Use Legal Structures to Hide their Stolen Assets and What to do About It*. Washington D.C.: World Bank, ps. 34-35.

(6) - FATF - Egmont Group (2018), *Concealment of Beneficial Ownership*, FATF, Paris, France, p.29.

- Facilitate a merger between two companies
 - The merger is structured to take place under a third, neutral shell company.
- Companies entering into a joint venture.
 - For multinational transactions, many companies prefer to seat their international joint-venture company in a neutral jurisdiction.
 - This ensures that no one company receives preferential legal treatment.
- Protect a corporate name from being used by another party.⁶
- Can be used as a company holding personal or family assets for ease of inheritance or as protection against attachment by creditors.
- Can be used as a personal holding company.



Why are Shell Companies used for ML?

Source:

(7) - OECD (2021), Ending the Shell Game: Cracking down on the Professionals who enable Tax and White-Collar Crimes.

- Provides an air of legitimacy for illicit finances.⁷
- Illegal funds can be disguised within legitimate business transactions by merging legal and illegal profits.
 - The funds can be then transferred either to other business entities or to domestic or foreign bank accounts.
- Conceals the origin and ownership of illicit funds within the façade of legitimate economic activity.
- Can be used in combination with other mechanisms to obscure beneficial ownership:
 - Exercising control secretly through contracts.
 - Adding layers of corporate vehicles.
 - Hiding behind bearer shares.
 - Ensuring that beneficial owners or the identifying information is located in another jurisdiction.



Why are Shell Companies used for ML?

Sources:

(8) - FATF - Egmont Group (2018), Concealment of Beneficial Ownership, FATF, Paris, France, p.26.

(9) - Ibid, p.29.

- Technique used by criminals to generate complex ownership and control structures through the use of legal persons and arrangements.
 - Particularly when established across multiple jurisdictions.⁸
 - Money may flow through multiple layers of shell companies before finally being withdrawn in cash or transferred to its final destination internationally.⁹
- Makes investigations by LEAs slow and costly.
 - The efforts in finding out true beneficial owners can hinder or delay investigations.
 - Frequently requires duplicative, slow-moving legal processes in several jurisdictions to gain the necessary information.



Estimates of Illicit Finances facilitated by Shell Companies

Sources:

(10) - FATF - Egmont Group (2018), Concealment of Beneficial Ownership, FATF, Paris, France, p.5

(11) - van der Does de Willebois, Emile, Emily Halter, Robert A. Harrison and Ji Won Park. (2011). The Puppet Masters: How the Corrupt Use Legal Structures to Hide their Stolen Assets and What to do About It. Washington D.C.: World Bank, p. 117.

(12) - Sharman, Jason. Preventing the misuse of shell companies by regulating corporate service providers. U4 Brief October 2013, No 7, p.1.

(13) - van der Does de Willebois, Emile, Emily Halter, Robert A. Harrison and Ji Won Park. (2011). The Puppet Masters: How the Corrupt Use Legal Structures to Hide their Stolen Assets and What to do About It. Washington D.C.: World Bank, p. 117.

- An analysis of 106 case studies demonstrates that legal persons, principally shell companies, are a key feature in schemes designed to disguise beneficial ownership.¹⁰
- A study of 150 grand corruption cases notes that “a vast majority” depend on the use of shell companies to hide the trail of dirty money.¹¹
- Shell company-enabled illicit financial flows is conservatively estimated to run into the tens of billions of dollars.¹²
- The Grand Corruption Database Project 213 examined grand corruption investigations involving public officials or those with the ability to wield significant power or political influence.¹³
 - Total proceeds of corruption amounted to approximately US\$56.4 billion, with 68 cases involving more than US\$20 million.



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.

Source:

A review of 150 cases of grand corruption from multiple jurisdictions worldwide in van der Does de Willebois et al., p.35.



Crimes Facilitated by Shell Companies

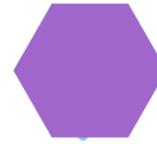
- 
- A decorative graphic consisting of a solid purple hexagon at the top, connected by a vertical dotted line to the list of crimes below.
- Drug trafficking
 - Human trafficking
 - Tax Evasion
 - Corruption
 - Money Laundering
 - Terrorism
 - Sanctions Evasion
 - Fraud



Environmental Vulnerabilities

Source:

FATF - Egmont Group (2018), Concealment of Beneficial Ownership, FATF, Paris, France, ps.77-85.



Jurisdictional vulnerabilities

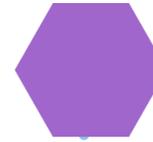
- Effectiveness of regulatory, enforcement, and supervisory measures.
 - Differences in the availability of beneficial ownership information.
 - Weak supervisory mechanisms due to capacity issues and the lack of a consistent approach for different types of professional intermediaries.
 - Minimal enforcement actions.
- Low-Tax Jurisdictions
 - Easier establishment of companies by foreign nationals that can disguise the beneficial owner and their assets.
 - Favourable return on investment made possible by tax concessions.



Environmental Vulnerabilities

Source:

FATF - Egmont Group (2018), Concealment of Beneficial Ownership, FATF, Paris, France, ps.77-85.



Trade and Financial Centres

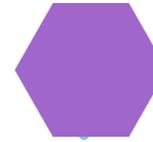
- Criminals tend to establish legal persons and bank accounts in major regional and global trade and financial centres to take advantage of domestic and international trade and finance trends.
- This legitimizes the legal person as a seemingly high-functioning and active business.
 - Legitimizes the transactions between two or more legal persons as lawful trade.
 - Conceals the unlawful transactions made by, or to, the legal persons behind the vast number and value of genuine transactions occurring across the same trade and finance channel.



Environmental Vulnerabilities

Source:

FATF - Egmont Group (2018), Concealment of Beneficial Ownership, FATF, Paris, France, ps.77-85.



Vulnerable Business Practices

- Online and Virtual Services
 - Reduces or removes the need for face-to-face interactions between intermediaries and clients.
 - Criminals can establish companies, business banking relationships and move money virtually.
 - More difficult to conduct CDD as fraudulent documents or nominees can be used to establish business relationships.
 - Allows unknown individuals to control bank accounts anonymously:
 - criminals will often coerce “straw men” to establish bank accounts
 - the “straw men” will hand over the account details, including internet banking login details to the criminal.
 - this disguises the beneficial owner of the account and to circumvent CDD obligations.



Environmental Vulnerabilities



Use of Third-Party CDD and Identity Verification

- Information provided by third-party service providers used for identity verification can be out-of-date or incomplete.
- This limits the effectiveness of CDD and can hide the beneficial owner.
- FIs may not always identify the deficiencies due to limited CDD mechanisms.

Reliance on Introduced Business

- FIs may rely on a lawyer or TCSP providing the company formation services and/or opening bank accounts on behalf of the newly created company for CDD according to Recommendation 17.
- A complicit or negligent can hamper the ability of the FI to identify beneficial ownership/suspicious activities to disguise ownership and control.

Source:

FATF - Egmont Group (2018), Concealment of Beneficial Ownership, FATF, Paris, France, ps.77-85.



Indicators of Shell Companies

- Formal nominees
 - Formal nominees may be “mass” nominees who are nominated agents for many shell companies.
- Informal nominees, such as children, spouses, relatives, or associates who do not appear to be involved in the running of the corporate enterprise.
- Address of mass registration
 - Usually, the address of a TCSP that manages several shell companies on behalf of its customers.
- Only a post-box address
 - Often used in the absence of professional TCSP services and in conjunction with informal nominees.

Source:

FATF – Egmont Group (2018), Concealment of Beneficial Ownership, FATF, Paris, France, ps.184-185.



Indicators of Shell Companies

- No real business activities undertaken.
- Exclusively facilitates transit transactions and does not appear to generate wealth or income.
- Transactions appear to flow through the company in a short period of time with little other perceived purpose.
- No personnel
 - There may be only a single person as a staff member.
 - Pays no taxes, superannuation, retirement fund contributions or social benefits.

Source:

FATF - Egmont Group (2018), Concealment of Beneficial Ownership, FATF, Paris, France, ps.184-185.



Measures to Prevent the Illicit Use of Shell Companies

Source:

Sharman, Jason. Preventing the misuse of shell companies by regulating corporate service providers. U4 Brief October 2013, No 7. p.2

- Effective regulation of professional intermediaries.
- Increased AML/CFT education/awareness amongst professional services sectors.
- Licensing TCSPs
 - All TCSPs should be licensed by a government regulator.
 - Those without/revoked licenses should not be allowed to form or administer companies on behalf of others.
- Require use of local CSPs
 - Non-nationals forming a company should use a local, resident TCSP acting as an agent or company director in that jurisdiction.
 - Thus, the person forming the company must go through a regulated gatekeeper.



Measures to Prevent the Illicit Use of Shell Companies

Source:

Sharman, Jason. Preventing the misuse of shell companies by regulating corporate service providers. U4 Brief October 2013, No 7. p.2

(14) - According to the Interpretive Note of Recommendation 24, all the persons, authorities, entities and the company itself (or its administrators, liquidators or other persons involved in the dissolution of the company), should maintain the information and records referred to for at least five years after the date on which the company is dissolved or otherwise ceases to exist, or five years after the date on which the company ceases to be a customer of the professional intermediary or the financial institution. See p. 91 of the FATF International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation.

- Mandatory requirements for confirmed identification of beneficial owner.
 - TCSPs should be obliged to collect copies of the picture page of clients' passports, supported by other documents such as proof of residence.
 - These documents should be held on file for as long as the business relationship lasts, plus a period of some years afterwards.¹⁴
- Reporting of suspicious transactions.
 - Professional intermediaries should have an obligation to report suspicious activity to the Financial Intelligence Unit (FIU).
 - FIU should be able to access information held on file by CSPs concerning their clients.
 - CSPs should apply risk-based approach according to the risks assessed, as laid out in the FATF Methodology.
 - Beneficial ownership information should be available to local and foreign authorities on request.



Thank you!



Phone Number
1868-623-9667



Email Address
cfatf@cfatf.org



Website
www.cfatf-gafic.org