

UNDERSTANDING BENEFICIAL OWNERSHIP AND LEGAL ARRANGEMENTS FOR COMBATING MONEY LAUNDERING

Understanding Beneficial Ownership and Legal Arrangements for Combating Money Laundering

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1. INTRODUCTION

The goal of this assessment report is to be a guide for the private sector in Kosovo¹ of the concept of beneficial ownership, the importance of beneficial ownership transparency, relevant international standards, case studies related to money laundering involving corruption, fraud, tax evasion, cryptocurrency, and recommendations on how to help mitigate these risks. The report is based on relevant guidelines and publications issued by the Financial Action Task Force (“FATF”) and other international organizations and the author’s experience in both the private sector and in working with financial intelligence units around the world.

The UNDP Support to Anti-corruption Efforts in Kosovo (SAEK) III project works closely with the public and private sector to build Public Private Partnerships that contribute to better detection and prevention of financial crime. It is our hope that this publication will serve as a valuable tool for proactively combating complex financial maneuvers used to hide illicit proceeds from corruption and other offenses, and ultimately return that money to public funds. We wish to thank our partners and donors, the Swiss Development Cooperation office in Kosovo, and SIDA through the Swedish Embassy in Kosovo, for their support to UNDP’s SAEK III project.

1.1 DEFINITION OF BENEFICIAL OWNERSHIP

The “Beneficial Owner” definition used by FATF and other international organizations refers to the natural person(s) who ultimately owns or controls a customer and/or the natural person on whose behalf a transaction is being conducted. It also includes those persons who exercise ultimate effective control over a legal person or arrangement. Reference to “ultimately owns or controls” and “ultimate effective control” refer to situations in which ownership/control is exercised through a chain of ownership or by means of control other than direct control.²

¹References to Kosovo shall be understood to be in the context of United Nations Security Council resolution 1244 (1999).

² <http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-transparency-beneficial-ownership.pdf>

According to the Central Bank of Kosovo the beneficial owner is the **natural person** who meets one or more of the following criteria:³



- Owns (directly or indirectly) 25% or more of the legal person;
- Exercises effective control over the legal person;
- A transaction was conducted in his/her name;

1.2 DEFINITION OF LEGAL PERSONS

“Legal persons” is defined as any entities, other than natural persons, that can establish a permanent customer relationship with a financial institution or otherwise own property. This can include companies, bodies corporate, foundations, anstalt, stiftung, partnerships, or associations and other relevantly similar entities. This can include non-profit organizations (NPOs) that can take a variety of forms which vary between jurisdictions, such as foundations, associations, or cooperative societies.

The FATF definition of legal persons focuses on the natural (not legal) persons who actually own and take advantage of capital or assets of the legal person; as well as on those who really exert effective control over it (whether or not they occupy formal positions within that legal person), rather than just the (natural or legal) persons who are legally (on paper) entitled to do so.⁴

³ https://bqk-kos.org/repository//docs/korniza_ligjore/english/BQK-%20ANG-Udhezimi%20mbi%20identifikimin%20e%20pronareve%20perfitues.pdf

⁴ <http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-transparency-beneficial-ownership.pdf>

EXAMPLES:

- i) A company is legally owned by a second company according to its corporate registration information. The beneficial owners are actually the natural persons who are behind that second company or ultimate holding company in the chain of ownership and who are controlling it.
 - ii) Persons listed in corporate registration information as holding controlling positions within a company but who are actually acting on behalf of someone else, are not considered beneficial owners because they are ultimately being used by someone else to exercise effective control over the company.
 - iii) It includes natural persons on whose behalf a transaction is being conducted, even where that person does not have actual or legal ownership or control over the customer. This element of the FATF definition of beneficial owner focuses on individuals that are central to a transaction being conducted even where the transaction has been deliberately structured to avoid control or ownership of the customer but to retain the benefit of the transaction.
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1.3 DEFINITION OF LEGAL ARRANGEMENTS

A legal arrangement is defined as a relationship established pursuant to a contract between two or more parties that does not result in the emergence of a legal person (trusts being the most common). The FATF definition of beneficial owner also applies in the context of legal arrangements, meaning the natural person(s), at the end of the chain, who ultimately owns or controls a legal arrangement, including those persons who exercise ultimate effective control over a legal arrangement, and/or the natural person(s) on whose behalf a transaction is being conducted. However, in this context, the specific characteristics of legal arrangements make it more complicated to identify the beneficial owner(s) in practice.

Example:

- 1) In a trust, the legal title and control of an asset are separated from the equitable interests in the asset. This means that different persons might own, benefit from, and control the trust, depending on the applicable trust law and the provisions of the document establishing the trust (for example, the trust deed). In some countries, trust law allows for the settlor and beneficiary (and sometimes even the trustee) to be the same person. Trust deeds also vary and may contain provisions that impact where ultimate control over the trust assets lies, including clauses under which the settlor reserves certain powers (such as the power to revoke the trust and have the trust assets returned). This may assist in determining the beneficial ownership of a trust and its related parties.⁵

⁵ <https://www.assetprotectionplanners.com/asset-protection-trust/or-foundation/>

1.4 KOSOVO BUSINESS REGISTRATION

The Kosovo Business Registration Agency (KBRA) operates within the Ministry of Trade and Industry and is the only responsible institution for registration of businesses in Kosovo. KBRA operates based on an electronic database offering a simpler, faster process for free registration of new businesses and is realized through the connection with 29 municipal registration centers thereby offering a “one-stop-shop” solution.⁶

In Kosovo, the following profit making entities can be registered:

- Individual Business
- Common Partnership
- Limited Partnership
- Limited Liability Company
- Joint Stock Company
- Foreign Company
- Social Enterprise
- Public Enterprise
- Agricultural Cooperative
- Other Enterprises under the jurisdiction of KTA
- Licensing of Companies for Physical Security

Foreign entities may also register a branch office in Kosovo (it must be registered with the Registry as a foreign business organization according to the Law). A branch office is not a separate legal entity. Consequently, its rights and obligations pertain to the “parent” company and not to the branch office.

1.5 OVERVIEW OF LEGAL PERSONS

There are a wide variety of legal persons in other jurisdictions and not all types of entities exist in Kosovo but below is a general overview of some of the most common legal persons. It is important to understand the different types of legal persons as ownership of entities and assets can be held by any of these whether present in Kosovo or not. Please note that this is not a comprehensive list of every type of legal entity that exists worldwide but rather a selection of those that are most likely to be encountered by the Kosovo private and public sector.⁷

Anstalt

An Anstalt is a hybrid between a company limited by shares and a foundation. An Anstalt is an entity, which has no members, participants or shareholders. It differs from a company in that it has no duty to return profit and differs from a trust in that it has no obligation to a beneficiary. Anstalt do have, however, a holder of the founder’s rights. The founder can be either a legal person or a natural person, need not be resident in the host country and Anstalt must have a minimum

⁶ <https://www.rks-gov.net/EN/f126/business-development/business-registration>

⁷ <https://www.dlapiperintelligence.com/goinggloabal/corporate/>

capital of CHF 30,000 (approximately USD \$ 34,900). There is also no need for the founder identity to be notified to the registration office. These features, and the founders rights, and because an Anstalt can conduct many kinds of business, including non-trading activities (such as holding passive investments), has made them popular with foreign companies who use them as a holding company for overseas subsidiaries when trying to minimize tax in their home jurisdictions. Anstalt are a safe/easy place to park assets at tax time. There are two types of Anstalt; commercial and non-commercial, and they feature prominently in the finance system of Liechtenstein, where they are considered to be a Public Law Institution, though they are not able to be listed on the Stock Exchange

Stiftung

A stiftung is an institution/foundation which, with the aid of a property, pursues a purpose determined by the founder. A *stiftung foundation* exists to give effect to the stated, non-commercial wishes of its founder, as set out in a foundation deed and the articles of association (statutes). In effect, the assets with which the foundation is endowed become a separate legal entity. A stiftung foundation has no shares or members and is set up by a founder(s) in most cases to ensure the continuation of family assets. A stiftung foundation can have beneficiaries, and in that way they are in some way similar to the common law notion of trusts. The founders also have the right to transfer and terminate the foundation.

Stiftung are purely not for profit enterprises and commercial activities are generally not permitted to be conducted by them. This is the primary difference between an anstalt and a stiftung. Stiftung are usually administered by a board of trustees and there is no registration required to establish them. Stiftung are a civil law construct, found mostly in German-speaking areas. Civil law stiftung foundations have developed in Austria, Cyprus, Italy, Finland, Germany, the Netherlands (Stichting), Netherlands Antilles, Spain, Sweden (Stiftelse), Switzerland, Panama, St Kitts, Nevis, Bahamas, Anguilla, Antigua and Barbuda, Malta, Jersey, and Malaysia.

Foundation

A foundation is a permanent fund established and maintained by contributions for charitable, educational, religious, research, or other benevolent purposes but also private purposes (private foundations). Beneficial owners are the Founders to the extent they can exercise control on the director or board of directors, the director or board of directors because they are responsible for the day-to-day decisions, and the beneficiaries in case they are identifiable and limited in number.

Trust

A trust is a three-party fiduciary relationship in which the first party, the trustor or settlor, transfers ("settles") a property (often but not necessarily a sum of money) upon the second party (the trustee) for the benefit of the third party, the beneficiary. A trustee can be a natural person, a business entity or a public body. A trust is created by a settlor, who transfers title to

some or all of his or her property to a trustee, who then holds title to that property in trust for the benefit of the beneficiaries. The trust is governed by the terms under which it was created. In most jurisdictions, this requires a contractual trust agreement or deed. It is possible for a single individual to assume the role of more than one of these parties, and for multiple individuals to share a single role.

Private Company Limited by Guarantee (“CLG”)

A company limited by guarantee (CLG) is a type of corporation used primarily (but not exclusively) for non-profit organizations that require legal personality. A company limited by guarantee does not usually have a share capital or shareholders, but instead has members who act as guarantors of the company’s liabilities. Each member undertakes to contribute an amount specified in the articles (typically very small) in the event of insolvency or of the winding up of the company. A company limited by guarantee can distribute its profits to its members, if allowed to by its articles of association, but then it would not be eligible for charitable status. This type of legal entity exists in the United Kingdom, the Republic of Ireland, Australia, and certain other Commonwealth countries. Common uses of companies limited by guarantee include clubs, membership organizations, including students’ unions, residential property management companies, sports associations, workers’ co-operatives, other social enterprises, non-governmental organizations (NGOs) charities, healthcare companies, and at least one political party (the UK Independence Party).

Private Company Limited by Shares (“CLS”)

A private company limited by shares is a class of private limited company incorporated under the laws of England and Wales, Northern Ireland, Scotland, certain Commonwealth countries, and the Republic of Ireland. It has shareholders with limited liability and its shares may not be offered to the general public, unlike those of a public limited company.

“Limited by shares” means that the liability of the shareholders to creditors of the company is limited to the capital originally invested (i.e. the nominal value of the shares and any premium paid in return for the issue of the shares by the company). A shareholder’s personal assets are thus protected in the event of the company’s insolvency, but any money invested in the company may be lost.

A limited company may be “private” or “public”. A private limited company’s disclosure requirements are lighter, but its shares may not be offered to the general public and therefore cannot be traded on a public stock exchange. This is the major difference between a private limited company and a public limited company. Most companies, particularly small companies, are private.

Individual Business (“IB”)

Individual Business is an entity that can be formed and owned by only one natural person and does not have a separate legal status. The owner of such an entity has unlimited personal liability for the debts and obligations of the IB. Although the IB is not a legal person, it may contract, hold property, and sue or be sued in its own name or in the name of its owner. A personal business enterprise for the purpose of conducting an economic activity may choose to register or not with the Registry.

General Partnership (“GP”)

General Partnership is a partnership formed by two or more natural or legal persons, who undertake business activity for profit pursuant to the partnership agreement. The owners of such entities are jointly and severally liable for the debts and obligations of the GP. Such liability is unlimited. The GP is not a legal person but may be formed by legal persons who become general partners of the GP. The GP is managed by its general partner(s). Although the GP is not a legal person, it may contract, hold property, and sue or be sued in its own name or in the name of its owner.

Limited Partnership (“LP”)

Limited Partnership is a partnership formed by at least one general partner and at least one limited partner. The LP may be formed by natural persons or business organizations, who can serve either as general or limited partners. Although similar to the GP, the LP has at least one limited partner, whose personal liability is limited to the investment made by him/her into the LP. The limited partner is also limited as to his ability to manage or represent the LP. The LP is managed by its general partner(s). Although the LP is not a legal person, it may contract, hold property, and sue or be sued in its own name or in the name of its owner. The Registry has no authority to review a limited partnership agreement for legal or formal sufficiency and/or to refuse to register a limited partnership for any reason that relates to the form, content, or terms of the limited partnership agreement.

Limited Liability Company (“LLC”)

Limited Liability Company is a legal person formed and owned by one or more natural or legal persons, excluding NGOs. The LLC is legally separate and distinct from its owners. The personal liability of the owners is limited to the capital they invested in the LLC. The LLC is governed by the Shareholders Assembly and the Managing Director (or a Board of Directors). The shares of an LLC are distributed only to its founders and the company cannot conduct a public offering of its shares. There is no minimum capital or maximum shareholders. Foreign entities are permitted to own and participate in an LLC. Registration in the Registry is mandatory for an LLC to come into existence.

Joint Stock Company (“JSC”)

Joint Stock Company is a legal person owned by its shareholders but is legally separate and distinct from its shareholders. The shareholders have limited personal liability for the debts and obligations of the JSC. An initial capital of EUR 10,000 is required. A JSC may have a single shareholder. The shares of a JSC may be transferred by the owner(s) without the approval of other shareholders or the company. Shareholders elect the Board of Directors, which manages the JSC. The Board of Directors hires the officers, namely the senior managers of the JSC. A JSC may come into existence only by registering with the Registry.

Private Investment Company (“PIC”) / Offshore Company

A Private Investment Company is the general term used to describe legal entities incorporated offshore with the objective to keep and manage financial investments. Individuals can be

shareholders (for example members of a family) and directors and are entitled to receive profit distribution or return on the invested capital. The financial resources held by the PIC, are held in custody with a financial institution abroad. The decision on the application of resources is made by the directors, in the interest of PIC and its shareholders. These companies can be found in various countries such as the British Virgin Islands, Cayman Islands, Saint Lucia, Nevis, Panama, etc.

A PIC is usually constituted in an offshore jurisdiction, also known as “tax haven”, or favored tax jurisdiction. The main reasons to choose to incorporate a PIC are the following:

- Zero or low income taxation: The PIC is not subjected, in its jurisdiction, to income taxation, either on their profits or for distributions to shareholders, or at least it is subject to a much more favorable taxation;
- Legal stability: the legal system in these jurisdictions is often much more stable, ensuring that, in case of conflicts, contracts will be respected. In the case of some UK dependencies (British Virgin Islands, for example), the last judicial instance is the Privy Council, a UK court with centuries-old stable case law;
- Political stability: As a relevant part of the local population of these jurisdictions is employed in tourism or in activities related to the provision of services related to PICs and other entities (lawyers, accountants, professionals in the financial sector), the political interest in abruptly changing local rules is much lower;
- Greater simplicity and flexibility: The bureaucracy for opening and closing down a PIC, for example, is substantially smaller than that for opening and closing down an equivalent legal entity in other countries.

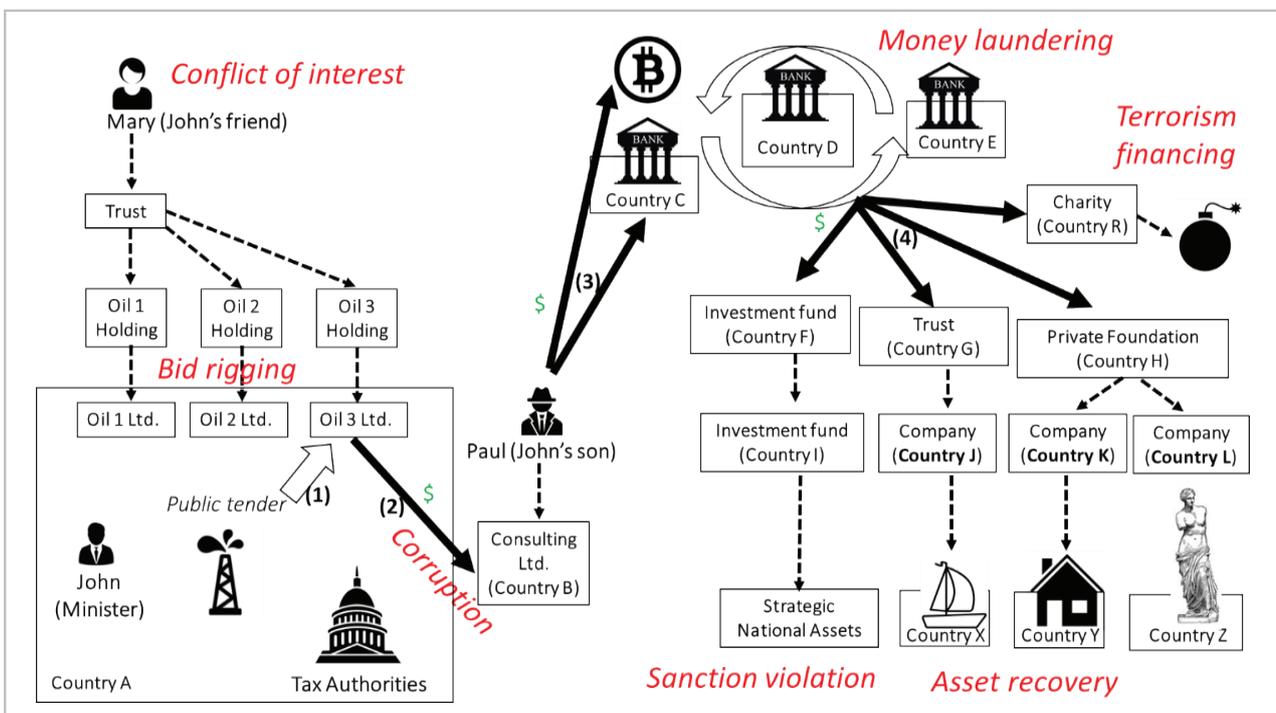
In short, the advantage in maintaining financial investments applied through a PIC is the utilization of a neutral and stable jurisdiction to organize ownership and management of the investments. The second is the simplification of tax and foreign exchange obligations.

2. CASE STUDIES

The methods used by money launderers identified through the following cases should be regarded as presented as practical guidance for financial institutions and designated non-financial businesses or professions to improve prevention and detection of money laundering activity, to assist with the identification of customers who may be engaged in criminal activities, and to improve the quality of suspicious activity reports (SARs). Data and information provided is derived from the private and public sector and has been sanitized.

2.1 CASE STUDY #1 – Complex Financial Crimes

This is a case study involving a variety of financial crimes that involves corruption, money laundering, terrorist financing, and sanctions violations.



Oil Contract – Bid Rigging

STEP ONE - In Country A, a bid for an oil exploration license was rigged as all three oil companies bidding were owned by the same ultimate beneficial owner (“UBO”) through three separate holding companies that were in turn all owned by a trust whose UBO was an individual named “Mary”. This individual was a close friend of the government minister in Country A named “John” that was in charge of selecting the winning company for the oil tender.

STEP TWO - The government minister was paid a bribe to participate in the rigged bid and the bribe payment was done as a consulting fee to a company located in Country B that is owned by the son of the government minister that was an individual named “Paul”.

STEP THREE - To launder the proceeds of corruption bank accounts were set up in Country C where crypto-currencies were purchased (arrow 3). Financial institutions from different countries such as countries D and E were also employed to conduct multiple financial transactions that would help conceal and lose traceability of the funds, as part of the money laundering process.

STEP FOUR - Once the money had been layered enough, it was used (arrow 4) through different legal vehicles (companies, trusts and private foundations) located in different countries (Countries I, J, K, L) to purchase hard assets such as a yacht, a house and art works that were ultimately owned by the son of the government minister named “Paul”. By investing through investment funds that pool together money from different investors the individual named “Paul” was able to acquire interests in strategic national assets (i.e., military, technology, or financial assets) even though “Paul” was in a sanction list since his name did not appear and the funds were comingled with that of other investors.

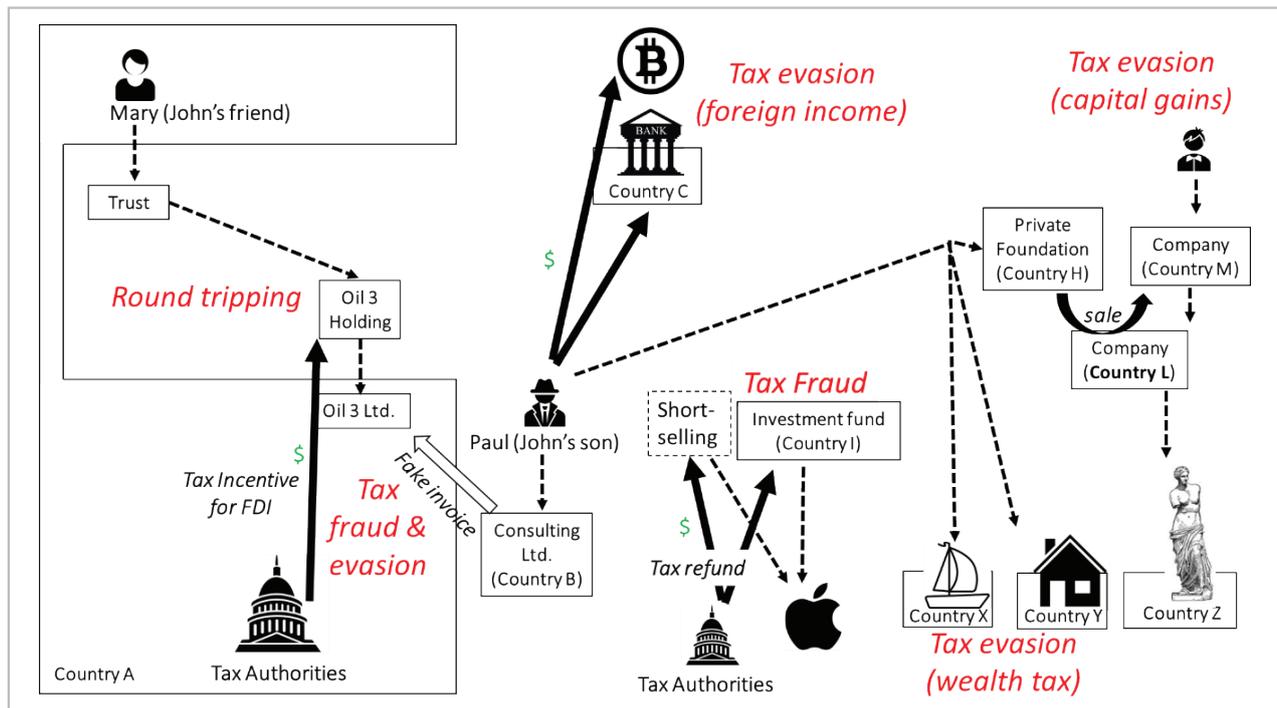
STEP FIVE - Part of the laundered funds were donated to a charity located in Country R but the charity was a cover for a terrorist organization which channeled the money to fund terrorist acts. It would be very difficult if not impossible for a single financial institution to be able to track all the financial transactions that took place. Information on the beneficial ownership of assets would be instrumental in being able to track the transactions to their source / ultimate beneficial owner. In this case if there existed registries for real estate, boats, and art works that could be accessed by both law enforcement and financial institutions it could have allowed to identify sanctions violations, recover assets, and identify corruption / undeclared income.

RED FLAGS – The following red flags were present:

- Use by a PEP of corporate vehicles (legal entities and legal arrangements) without a valid business reason and engaging in consulting contracts.
- Use of direct reports, family members, or close associates as legal owner of a corporate vehicle.
- Transactions conducted between non-client corporate vehicles and a PEP’s account(s).
- PEP uses multiple bank accounts for no apparent commercial or other reason and / or conducts transactions with multiple legal entities in third countries for no apparent business reason.

2.2 CASE STUDY #2 – Tax Evasion and Fraud

This is a case study involving tax evasion and fraud.



- STEP ONE –** In Country A an individual named “Mary” owned a company that improperly benefitted from a special tax regime meant for non-residents (i.e., a tax incentive to promote foreign direct investment), but the individual named ‘Mary’ is not a foreigner but a resident in the same country.
- STEP TWO –** The individual named “Paul” received a bribe to use his company located in Country B to simulate providing a consulting service to Mary’s company by issuing a fake invoice even though no service took place (tax fraud). This way, Mary’s company inflated its costs to declare losses (no profit) engaging in tax evasion.
- STEP THREE –** Third, the individual named “Paul” failed to declare income from investing in foreign assets through a bank in Country C therefore engaging in tax evasion. Tax authorities in Country A were unable to find out about “Paul’s” foreign income as there was no international tax exchange agreement in place.
- STEP FOUR –** Fourth, the individual named “Paul” set up a private foundation in Country H through which he purchased a yacht in Country X, a home in Country Y, and an antique statue in Country Z purchased through a company in Country L. By not declaring asset holdings the individual named “Paul” engaged in tax evasion related to wealth tax.
- STEP FIVE –** The private foundation indirectly sold the artwork to an individual in Country M by transferring ownership of company L which directly held the artwork, instead of selling the artwork itself. By performing the indirect sale. the individual named “Paul” evaded capital gains tax because tax authorities would not be able to know that

the artwork was effectively sold (authorities would only see that the artwork is still owned by Company L). The sale would only be revealed by looking at the change of legal and beneficial owners above the statue's direct holder (Company L).

STEP SIX -

Finally, the individual named "Paul" defrauded tax authorities by having a company in Country I to simulate ownership of shares in a listed company, in specific days when dividends are distributed, dividend tax has to be paid and when dividend tax refunds apply. The tax scheme refers to simulating ownership to obtain an inappropriate tax refund for taxes on dividends. When dividends are distributed, a dividend tax may apply. Some investors may be entitled to a refund of the paid dividend tax, for example based on their residency. In this case, the shares held by the investor without a right to a dividend tax refund are lent to an investor that does have the right to a reimbursement. Afterwards, the shares are returned to the original owner, and the inappropriate reimbursement is shared among both parties. A more sophisticated variation of this scheme occurs when two (or more) different investors own the same share allowing each of them to obtain a reimbursement of the dividend tax. However, only one investor held the share at the relevant time and paid the dividend tax. Beneficial and legal ownership transparency over shares, especially indicating a history of changes, would reveal these abuses.

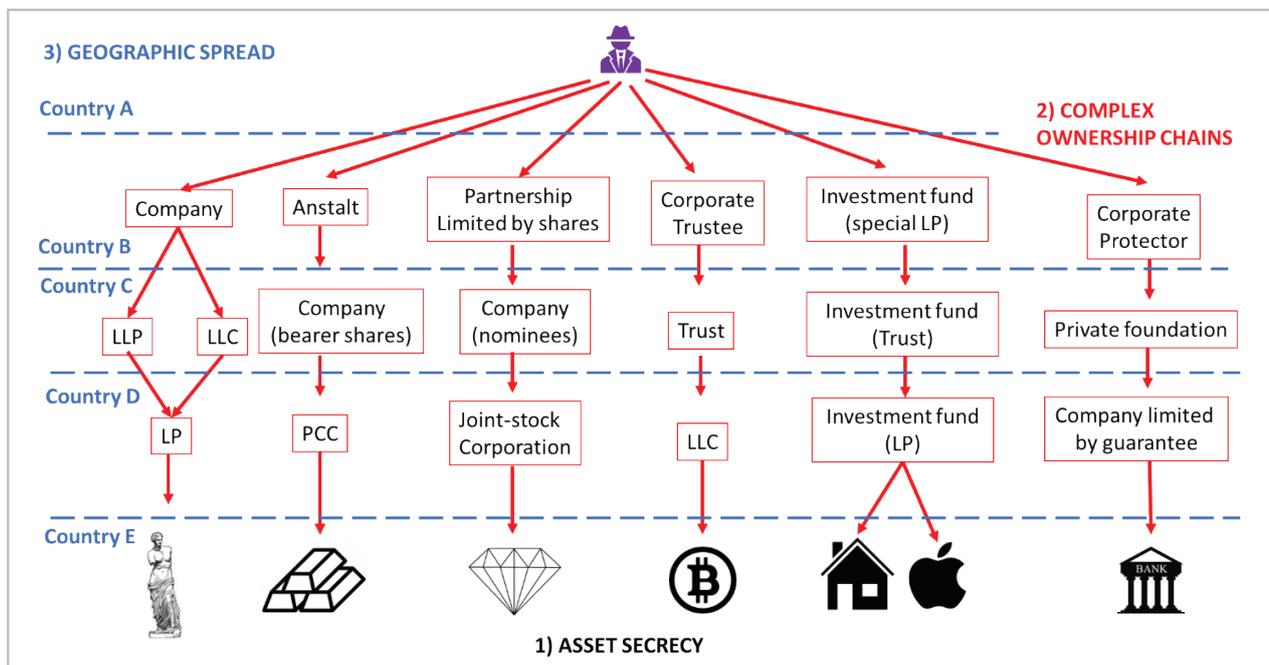
Avoiding these type of financial crimes requires transparency on legal and beneficial ownership on assets and the legal vehicles that hold them.

RED FLAGS – The following red flags were present:

- Use by a PEP of corporate vehicles (legal entities and legal arrangements) without a valid business reason, engaging in consulting contracts, and investing in / purchasing assets in third countries.
- Use of direct reports, family members, or close associates as legal owner of a corporate vehicle.
- Transactions conducted between non-client corporate vehicles and a PEP's account(s).
- PEP uses multiple bank accounts for no apparent commercial or other reason and / or conducts transactions with multiple legal entities in third countries for no apparent business reason.

2.3 CASE STUDY #3 – Extensive Use of Layering / Legal Entities

This is a case study involving of the asset ownership structure related to the money laundering scheme involving former Ukrainian president Victor Yanukovich.



STEP ONE – Assets held by different legal entities were assets that did not require registration such as art objects, gold and cash, jewelry, cryptocurrency or were assets that required only legal ownership information but not the name of the ultimate beneficial owner(s) such as real estate.

STEP TWO – All the assets were not held by an individual or even one entity but by multiple legal entities in complex ownership chains spread out through five different countries based on their legal regime and levels of cooperation. This was done by selecting legal entities in jurisdictions where information about legal ownership is not reported for certain asset categories or types of legal vehicles, or information is not required to be updated when legal ownership changes, or beneficial ownership information may also not be maintained in some jurisdictions or verification and enforcement is lax, or the jurisdictions do not exchange information with other countries.

STEP THREE – To further increase the level of secrecy the legal vehicles used included companies that had issued bearer shares, companies that had nominee shareholders (including family members), and companies that did not need to register or update their legal and beneficial ownership information with a central register such as trusts. The ownership structure also included a circular ownership scheme (i.e., Company A was owned by Company B that in turn was owned by Company A) and distributing shareholdings below regulatory threshold registration requirements.

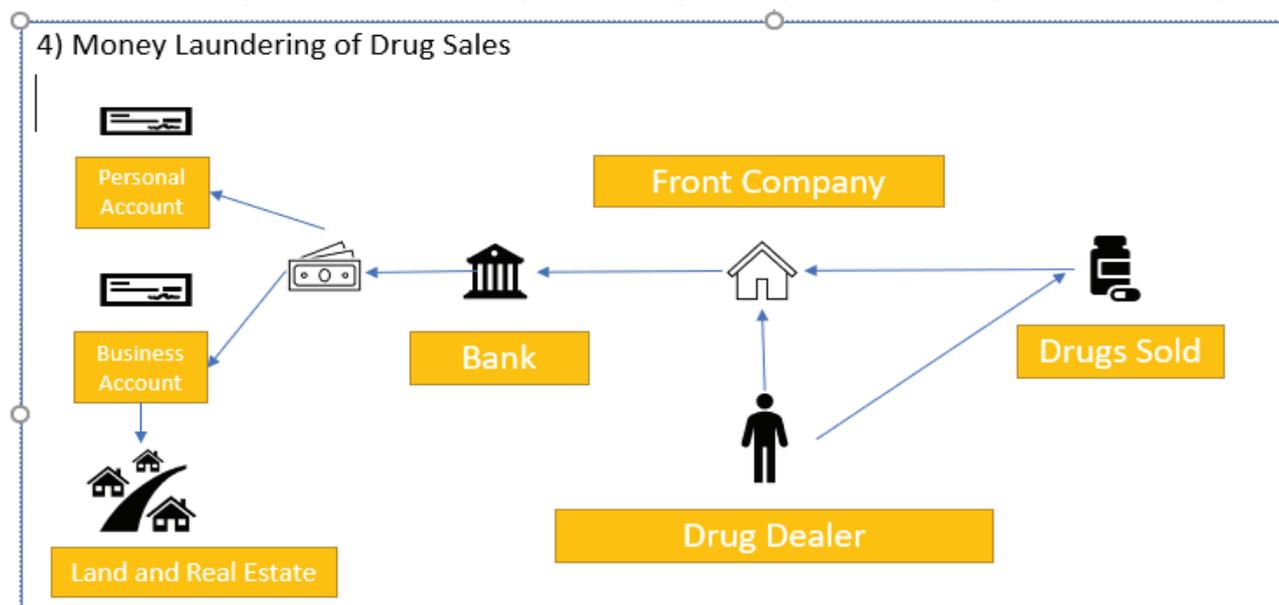
STEP FOUR – To further obfuscate the ownership structure the legal vehicles used also had distinct control structures. For example, companies limited by shares or companies limited by guarantee were owned by partnerships with different types of partners (general and limited ones) or by trusts and private foundations that did not have owners but different parties with different roles and rights (a settlor or founder, a trustee or council of administration, a protector, and beneficiaries).

RED FLAGS – The following red flags were present:

- Use by a PEP of corporate vehicles (legal entities and legal arrangements) without a valid business reason, engaging in consulting contracts, and investing in / purchasing assets in third countries.
- Use of direct reports, family members, or close associates as legal owner of a corporate vehicle.
- Excessively complex ownership structure of legal entities with no valid business reason.
- Transactions conducted between non-client corporate vehicles and a PEP's account(s).
- PEP uses multiple bank accounts for no apparent commercial or other reason and / or conducts transactions with multiple legal entities in third countries for no apparent business reason.

2.4 CASE STUDY #4 – Money Laundering of Drug Proceeds

This is a case study that involves money laundering of drug proceeds using a front company.



STEP ONE – An individual named “Mr. A” incorporated a business in Country A indicating that it was a tattoo and retail shop. The incorporation documents showed “Mr. A” and an individual named “Mr. B” to each be 50% owners of the business.

STEP TWO - The individual named “Mr. A” then opened a personal account and a business account in a bank in Country A and indicated that the expected account activity should be US \$5,000 per month. The business bank account immediately saw daily cash credits followed by cash withdrawals with no debits for rent or utility payments or salary payments. After several months of this type of activity the personal account started to reflect a monthly internal bank transfer of US \$5,000 indicated as salary followed by same day cash deposits into the personal account for amounts varying between US \$3,000 and US \$5,000. The deposits in the personal account were followed by significant cash withdrawals on an irregular basis and of varying amounts.

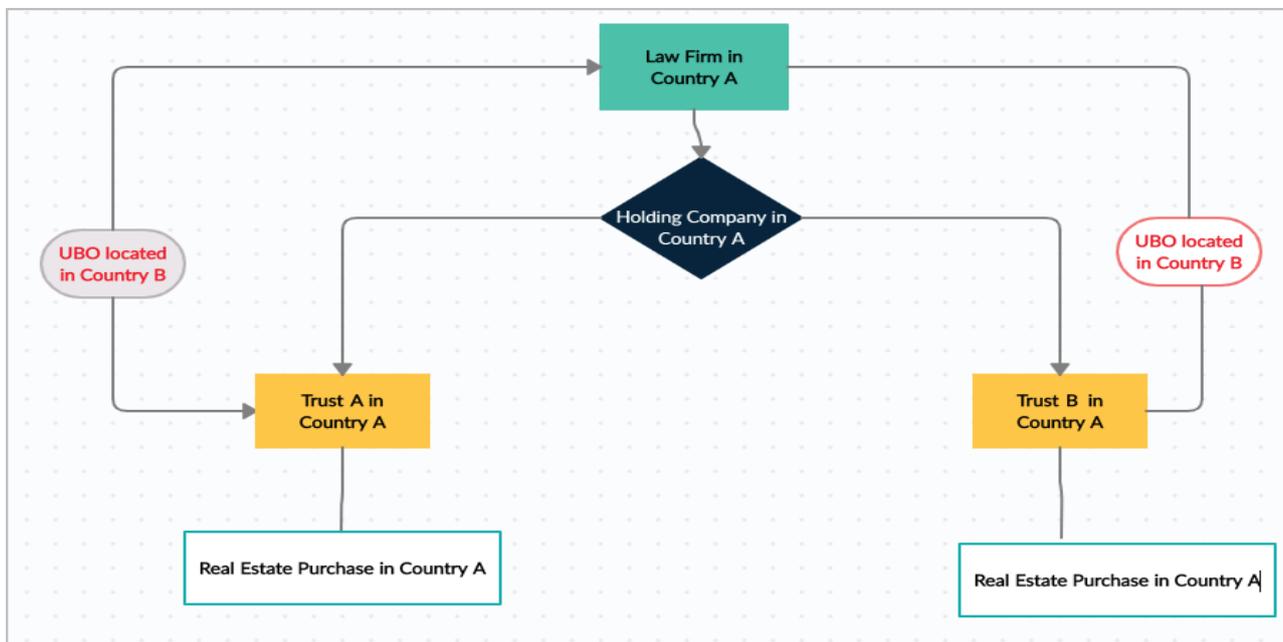
STEP THREE - Wire transfers from the business account also occurred in an irregular basis and of varying amounts to an account held overseas and titled land purchase. Examination of the personal account showed a notification to the bank of overseas travel on a regular basis and the usage of the debit card overseas. This notification also correlated with a large cash withdrawal requested in USD from the account a day or two before travel. An investigation led to the conclusion that the individual derived income from drug sales and the tattoo and retail shop was merely a front company used to launder money and used to purchase land and real estate in Country B.

RED FLAGS – The following red flags were present:

- High velocity in terms of account activity with no apparent useful business purpose
- Large amount of business activity conducted in cash for no apparent business purpose.
- Constant comingling of personal and business accounts with no apparent business purpose.
- Excessive cash withdrawals from a business account prior to foreign travel

2.5 CASE STUDY #5 – Money Laundering of Fraud Proceeds using Trusts

This is a case study that involves money laundering of fraud proceeds by using trusts to buy real estate.



STEP ONE - Two trusts were established in “Country A” by a law firm as primary shareholder of a Holding Company.

STEP TWO - The trustee was directed to accept two payment orders in favor of a bank in order to buy real estate in the name of the Holding Company in Country A. The

trustees contacted a local Real Estate agent who assisted in the holding company purchasing two properties for US\$450,000 and US\$650,000. The law firm controlled all communications regarding the trusts and the trustees had no idea who the beneficiaries were. Individuals “Y” and “Z” were the beneficiaries of the trusts.

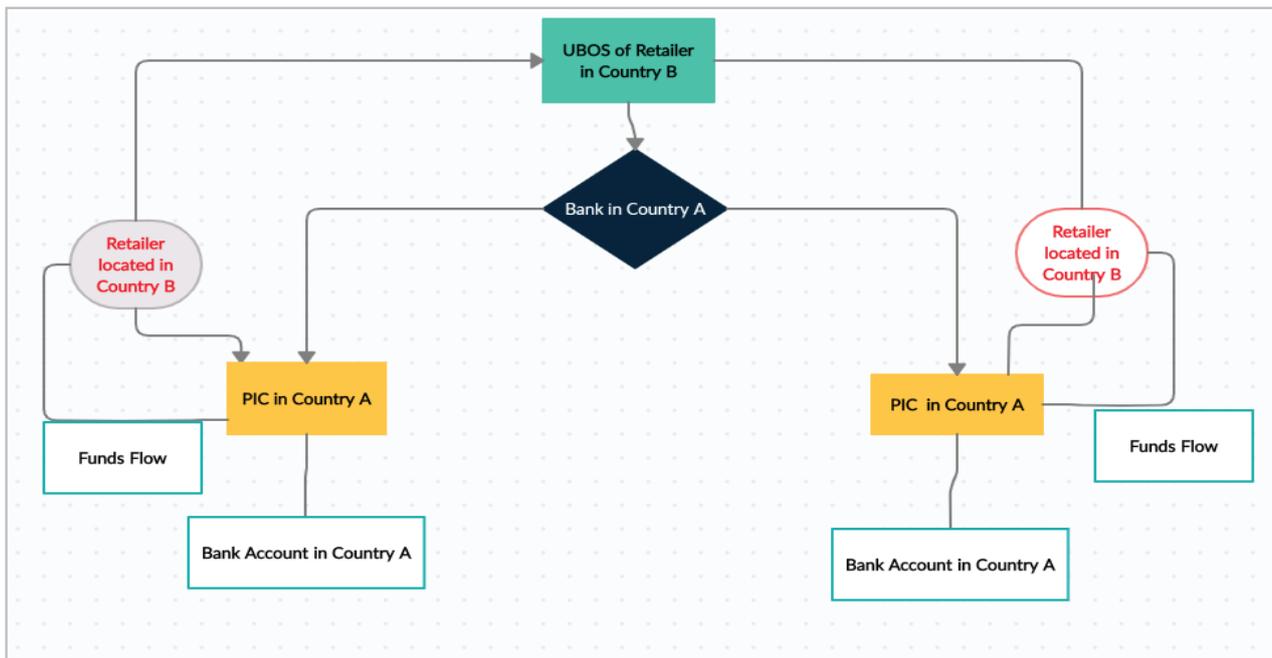
STEP THREE - Individuals “Y” and “Z” were Senior Managers of two fund management companies, established in Country B and were the subject of a fraud investigation regarding serious misappropriation of the funds in excess of US\$1million. The funds in the trusts originated from criminal activity of the companies. The trust had been used to conceal the identity of the beneficial owners and to launder the funds by purchasing real estate in Country A.

RED FLAGS – The following red flags were present:

- Use of trusts by investment fund managers without a valid business reason.
- Use of a law firm to shield from the trustees the identity of the ultimate beneficial owners.

2.6 CASE STUDY #6 – Money Laundering of Fraud Proceeds using PICs

This is a case study that involves money laundering of fraud by using Private Investment Companies (“PICs”).



STEP ONE - Two Private Investment Companies (“PICs”) were established in Country A by the primary shareholder of a retailer in Country B. The shareholder, an individual named “Mr. X”, was the son of the President of Country A. Mr. X also had a brother named “Mr. Y”. Mr. X was the ultimate beneficial owner of the PICs and an individual named “Mrs. Z” was a director of these companies.

STEP TWO – The two PICs opened bank accounts at a bank located in Country A. The clients' source of funds was declared as dividends received as a shareholder of a retail business in Country B.

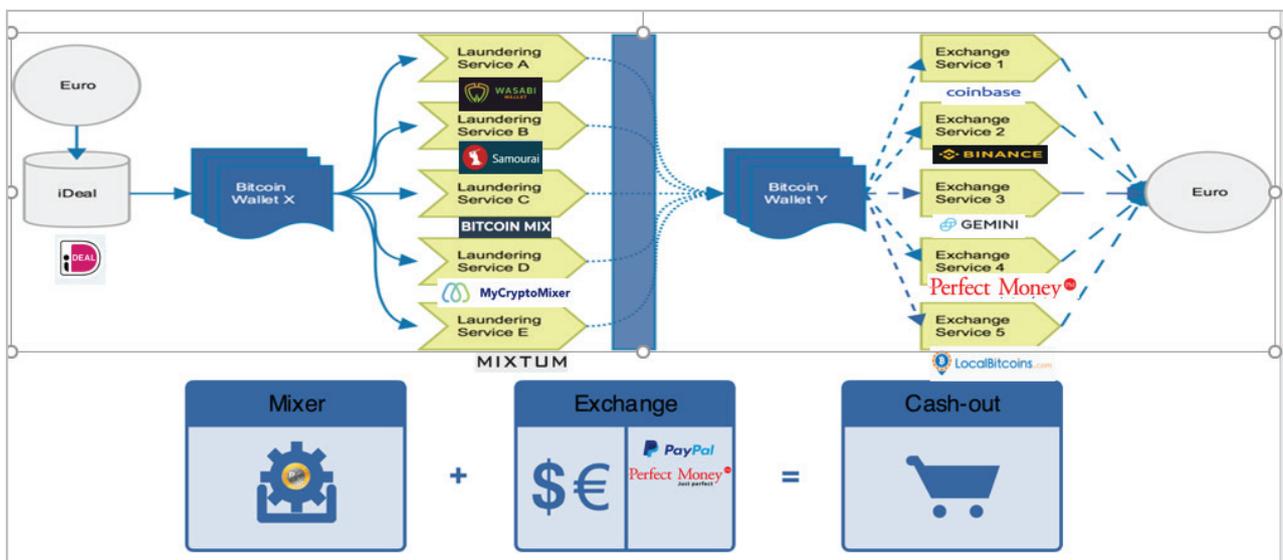
STEP THREE – Funds were sent from Country B to Country A as dividend payments from the retailer. The funds were bribes paid to the shareholder by an international conglomerate that was seeking to obtain government contracts and licenses. The PICs had been used to conceal the source of funds. Mr. X was laundering money in Country B, and Mrs. Z was setting up transactions for millions of dollars in bribes to pass from the international conglomerate to Messrs. X and Y.

RED FLAGS – The following red flags were present:

- Use of private investment companies without a valid business reason.

2.7 CASE STUDY #7 – Money Laundering using Cryptocurrency

This is a case study that involves money laundering using cryptocurrency.



STEP ONE – An individual named “Mr. X” created an anonymous email by setting up a Lelantos email account for communication (Lelantos is a form of Tor email / anonymous email that disguises true ownership).

STEP TWO – The individual named “Mr. X” then used Euros to purchase Bitcoin through a payment service provider located in Europe by setting up a Bitcoin Wallet “X” and storing the Bitcoins on 5 different Bitcoin addresses.

STEP THREE – The individual named “Mr. X” created a Bitcoin Wallet “Y” with 5 different Bitcoin addresses.

STEP FOUR – The individual named “Mr. X” transferred Bitcoin from Wallet X to 5 different cryptocurrency mixing services by using Bitcoin addresses provided by the mixers. Once the coins were mixed / cleaned the Bitcoins were transferred to Wallet Y.

STEP FIVE – The individual named “Mr. X” then transferred Bitcoin from Wallet Y to 5 different

cryptocurrency exchanges that exchange Bitcoin for fiat currency by using Bitcoin addresses provided by the exchanges to receive the Bitcoin. Mr. X indicated to the 5 exchanges the output platform for the Bitcoin.

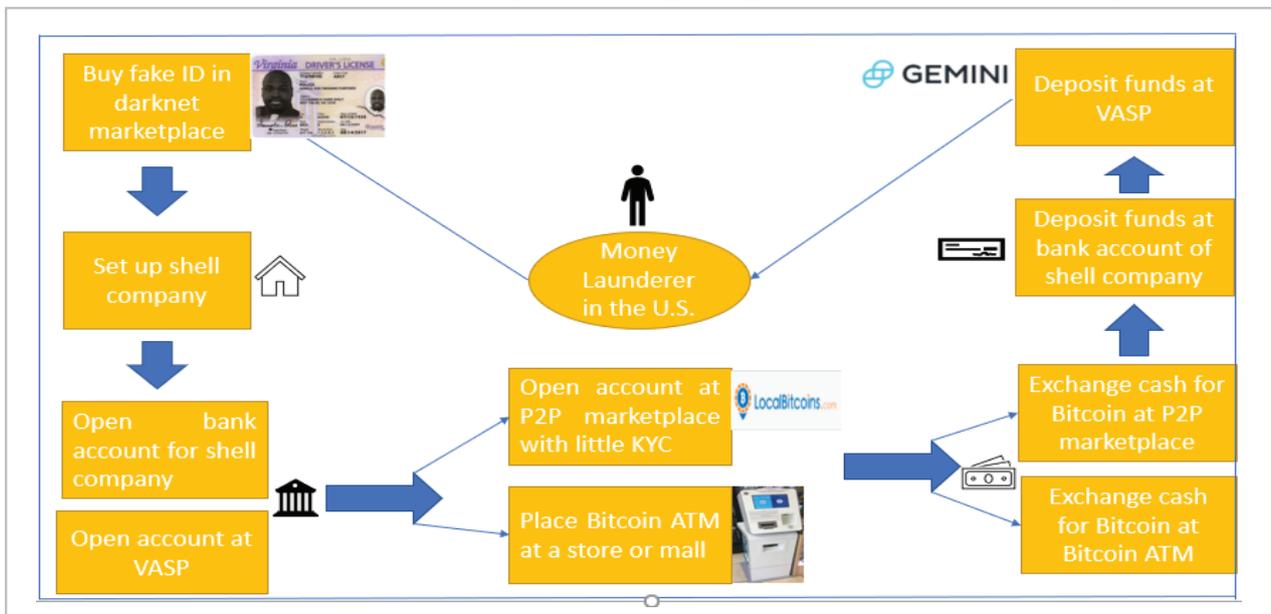
All these steps were done in the time-span of one day but actual cash-out can take 1 to 3 days, depending upon the output platform used.

RED FLAGS – The following red flags were present:

- Use of anonymous email for communication.
- Use of multiple wallets and bitcoin addresses, use of multiple currency mixers, and use of multiple currency exchanges to conduct crypto to fiat transactions and vice versa.

2.8 CASE STUDY #8 – Money Laundering using Darknet Market and Cryptocurrency

This is a case study that involves money laundering using the darknet market and cryptocurrency.



STEP ONE – An individual named “Mr. X” used the Tor network to purchase a fake ID in the darknet marketplace and paid for it with Bitcoin and using a mixing service.

STEP TWO - The individual named “Mr. X” set up a shell company in Country A using the fake ID to identify himself.

STEP THREE - The individual named “Mr. X” opened a business bank account and an account at a virtual asset service provider (“VASP”) using the fake ID.

Note: A Virtual Asset Service Provider is defined by the Financial Action Task Force (FATF) as a business that conducts one or more of the following actions on behalf of its clients:

- exchange between virtual assets and fiat currencies
- exchange between one or more forms of virtual assets
- transfer of virtual assets
- safekeeping and/or administration of virtual assets or instruments enabling control over virtual assets
- participating in and provision of financial services related to an issuer's offer and/or sale of a virtual asset

This definition encompasses a range of crypto businesses, including exchanges, ATM operators, wallet custodians, and hedge funds.

STEP FOUR - The individual named "Mr. X" opened an account at a peer to peer (P2P) marketplace with little KYC requirements using the fake ID to advertise his services to buy and sell Bitcoins. The individual offered commission only exchanges and set US \$5,000 per transaction as the minimum amount essentially acting as an unlicensed money service business ("MSB") providing cryptocurrency-to-fiat currency exchange.

STEP FIVE - The individual named "Mr. X" deposited funds from the unlicensed MSB activity into the business bank account. Mr. X frequently made large transfers from the business bank account to his account at a US-based cryptocurrency exchange named Gemini ("Gemini Trust Company LLC").

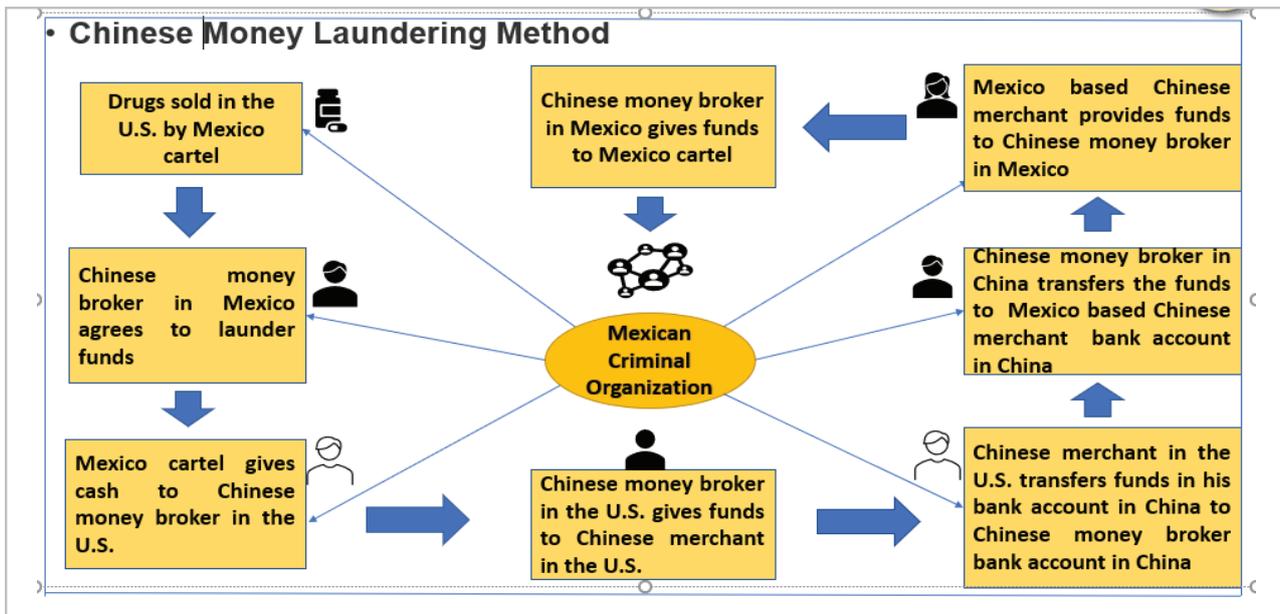
STEP SIX - The individual named "Mr. X" set up a Bitcoin ATM at a liquor store that had a high volume of customers allowing for large amounts of cash to Bitcoin exchange. The ATM received a lot of customers as Mr. X had disabled the camera of the ATM and required no identification to use as Mr. X had no KYC requirements, record keeping, or reporting.

RED FLAGS – The following red flags were present:

- Use of anonymous email for communication.
- Use of multiple wallets and bitcoin addresses, use of multiple currency mixers, and use of multiple currency exchanges to conduct crypto to fiat transactions and vice versa.
- Large amount / frequency of transactions.

2.9 CASE STUDY #9 – Money Laundering using Modern Hawala with Cryptocurrency

This is a case study that involves money laundering using a modern version of hawala using cryptocurrency.



STEP ONE – A Mexican criminal organization sells drugs in the U.S. and wants to bring proceeds from U.S. drug sales back to Mexico. It contacts Chinese money brokers operating in Mexico to see who offers the cheapest rates.

STEP TWO – The parties agree on a commission and the amount to be laundered, say \$500,000.

STEP THREE – The Chinese broker, using encrypted phone messages, would send the Mexican criminal organization three things:

- 1. a code word
- 2. the number of a U.S. burner phone (no contract throw-away phones purchased in cash at large department stores)
- 3. the unique serial number of an authentic \$1 bill

STEP FOUR – The Mexican crime group shares those details with a cartel-linked drug dealer in the United States, who calls the burner phone and identifies himself by using the code word. He arranges to meet a U.S.-based money courier working for the Chinese broker.

STEP FIVE – The drug dealer and the money courier meet in public. The courier hands over a \$1 bill with the unique serial number. When that checks out, the dealer hands over the cash, keeping the bill as a “receipt.”

STEP SIX – The courier takes the US \$500,000 to a U.S.-based Chinese merchant who has a bank account in China. The merchant then performs a currency swap known as a “mirror transaction.” He takes possession of the U.S. cash and then transfers US \$500,000 worth of Chinese yuan from his Chinese bank account to the money broker’s Chinese account, using an account number provided to him by the courier and engaging in fiat to cryptocurrency exchange prior to doing the bank to bank wire to further layer the transaction.

STEP SEVEN – The cartel’s drug cash is now sitting in a Chinese bank, outside the view of U.S. law enforcement. The broker has two options to send it on to Mexico to the drug cartel.

STEP EIGHT – Option 1 is to do another “mirror transaction.” The US \$500,000 worth of yuan is now transferred from the money broker’s Chinese account to the Chinese bank account of a Mexico-based businessperson. That Mexico-based businessperson then provides US \$500,000 worth of Mexican pesos to the money broker in Mexico, who delivers that cash to the cartel.

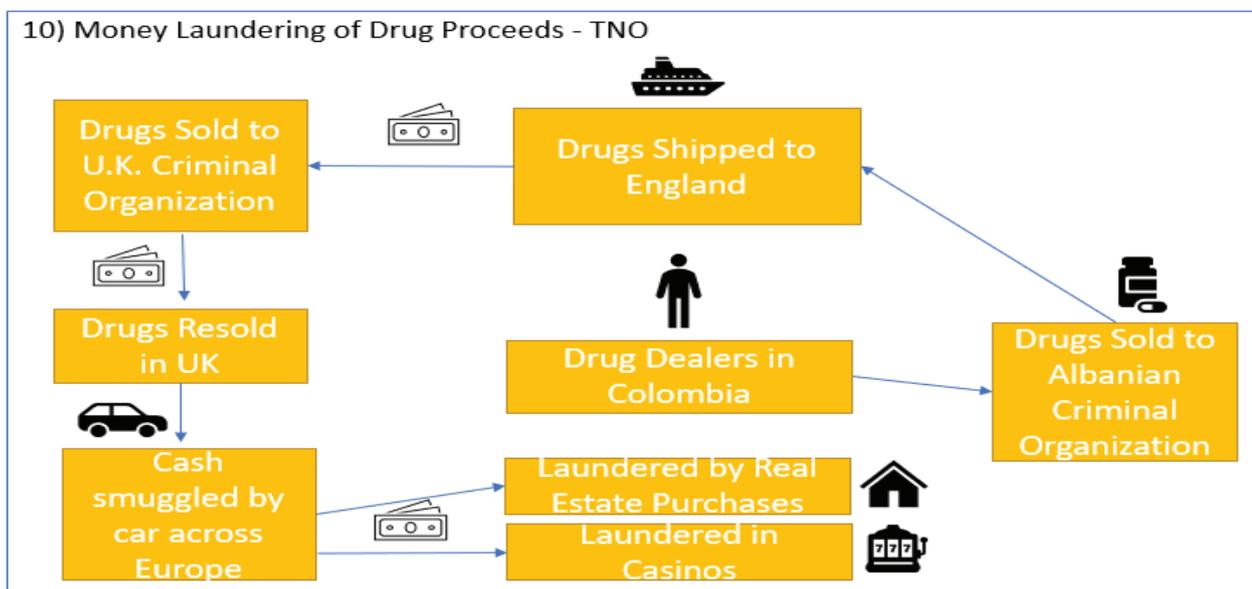
STEP NINE – Option 2 is for the Chinese money broker buys US \$500,000 worth of consumer products in China, such as clothing, shoes, chemicals, and exports them to Mexico. The goods are then sold, and the proceeds delivered to the cartel.

RED FLAGS – The following red flags were present:

- Avoidance of the financial system to conduct transactions which leads to unexplained wealth.
- Engaging in fiat to cryptocurrency exchange prior to doing the bank to bank wire to further layer the transaction.

2.10 CASE STUDY #10 – Money Laundering of Drug Proceeds – Transnational Organization

This is a case study that involves money laundering by a transnational criminal organization.



STEP ONE – A Albanian criminal organization buys drugs in Colombia directly from the large drug organizations and takes the drugs to England by ship.

STEP TWO – The drugs are smuggled in and resold to local UK criminal organizations.

STEP THREE – The cash from the drug sales is smuggled by car across the Channel tunnel into France and from there to Albania.

STEP FOUR – The cash is used to buy real estate in various European countries and is also laundered in casinos.

RED FLAGS – The following red flags were present:

- Avoidance of the financial system to conduct transactions which leads to unexplained wealth.
- Using cash to purchase real estate.
- Showing constant casino wins or losses.

3. CONCEALMENT OF BENEFICIAL OWNERSHIP – RED FLAGS

The indicators below may be a sign of concealment of beneficial ownership.⁸

3.1 Individuals

- Use an intermediary (either professional or informal) in all interactions without sufficient justification
- Avoid personal contact without justification
- Have no significant dealings in the country in which they are procuring professional or financial services or to purchase assets
- Refuse to provide information and documents required to facilitate a transaction
- Are politically exposed persons, or have familial or professional associations with a person who is politically exposed
- Are conducting transactions which appear strange given an individual's age
- Have previously been convicted for fraud, tax evasion, or serious crimes
- Are under investigation or have known connections with criminals
- Are authorized signers to company accounts without sufficient explanation
- Conduct financial activities and transactions inconsistent with their customer profile
- Have declared income which is inconsistent with their assets, transactions, or lifestyle.

3.2 Legal Persons

- Have demonstrated a long period of inactivity following incorporation, followed by a sudden and unexplained increase in financial activities
- Describe themselves as a commercial business but cannot be found on the internet or social business network platforms
- Are registered under a name that does not indicate the activity of the company

⁸ <https://www.fatf-gafi.org/documents/news/transparency-and-beneficial-ownership.html>

- Are registered under a name that indicates that the company performs activities or services that it does not provide
- Are registered under a name that appears to mimic the name of other companies, particularly high-profile multinational corporations
- Use an email address with an unusual domain (such as Hotmail, Gmail, Yahoo, etc.) or an anonymous email (Lelantos)
- Are registered at an address that does not match the profile of the company
- Are registered at an address that cannot be located on internet mapping services (such as Google Maps)
- Are registered at an address that is also listed against numerous other companies or legal arrangements, indicating the use of a mailbox service
- The director or controlling shareholder(s) cannot be located or contacted
- The director or controlling shareholder(s) do not appear to have an active role in the company
- The director, controlling shareholder(s) and/or beneficial owner(s) are listed against the accounts of other legal persons or arrangements, indicating the use of professional nominees
- Have declared an unusually large number of beneficiaries and other controlling interests
- Have authorized numerous signatories without sufficient explanation or business justification
- are incorporated/formed in a jurisdiction that is considered to pose a high money laundering or terrorism financing risk
- Are incorporated/formed in a low-tax jurisdiction or international trade or finance centers
- Regularly send money to low-tax jurisdictions or international trade or finance centers
- Conduct a large number of transactions with a small number of recipients
- Conduct a small number of high-value transactions with a small number of recipients
- Regularly conduct transactions with international companies without sufficient corporate or trade justification
- Maintain relationships with foreign professional intermediaries in the absence of genuine business transactions in the professional's country of operation
- Receive large sums of capital funding quickly following incorporation/formation, which is spent or transferred elsewhere in a short period of time without commercial justification
- Maintain a bank balance of close to zero, despite frequent incoming and outgoing transactions

4. REGULATORY TRENDS

4.1 European Union (“EU”)

The EU 4th anti money laundering directive (AMLD) in 2015 established beneficial ownership registers for legal persons incorporated in the EU and for trusts administered in the EU that generated tax consequences.⁹ The EU 5th anti money laundering directive in 2018 extended beneficial ownership registration for all trusts administered in an EU country (regardless of tax consequences), and also broadened the scope to cover also trusts administered outside the EU that acquired real estate or that established business relationships in the EU. An important feature of AMLD 5 refers to access to beneficial ownership information. Information on beneficial owners of legal persons would become publicly accessible and for trusts, access would be subject to a legitimate interest.¹⁰

4.2 United Kingdom (“UK”)

In the United Kingdom the “Overseas Entities Bill” issued in 2018 is a new beneficial ownership register that will be implemented in 2021 that will include overseas entities that own property in the UK.¹¹

All overseas entities that are purchasing land, already own land, or have a lease over land for longer than seven years in the UK will be required to:

- identify their beneficial owner(s); and
- provide information about itself, its beneficial owners and managing officer(s) to Companies House.

⁹ https://www2.deloitte.com/content/dam/Deloitte/ie/Documents/FinancialServices/investmentmanagement/ie_2015_The_Fourth_EU_Anti_Money_Laundering_Directive_Deloitte_Ireland.pdf

¹⁰ https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-supervision-and-risk-management/anti-money-laundering-and-counter-terrorist-financing_en

¹¹ <https://www.gov.uk/government/publications/economic-crime-plan-2019-to-2022/economic-crime-plan-2019-to-2022-accessible-version>

Examples of information that will be disclosed include the name / registered office of the overseas entity / beneficial owner and crucially, the basis on which the named entity / individual is considered a registerable beneficial owner.

Therefore, the new regime means that individuals who own UK property through an overseas entity will now see their personal information on a public register. The information must be reviewed and updated annually. Certain exemptions from reporting may apply. An overseas entity is, as currently defined, a body corporate, a partnership or other legal person governed by the law of a country or territory outside the UK.

In terms of trusts, they do not have legal personality and so do not fall within the definition (but non-UK resident trusts acquiring land in the UK will be required to register with the UK Trusts Registration Service when a tax liability arises in respect of that land). Those that hold UK residential property via an overseas entity, as defined in the bill, will be subject to the new Overseas Entities regime, though not (as matters currently stand) also with the Trust Registration Service.

A 'beneficial owner(s)' may be an individual, legal entity, government, or public authority which:

- owns more than 25% of the shares or voting right in the overseas entity;
- has the right to appoint or remove a majority of the board of directors; and
- exercises, or has the right to exercise, significant influence or control.

Penalties for non-compliance

The most significant property-related consequences for non-compliance are that:

- an overseas entity that purchases UK property will not be able to register as the proprietor of such property at the Land Registry until it has complied (i.e., it has notified Companies House of beneficial ownership); and
- an overseas entity that owns UK property which is already registered at the Land Registry as the proprietor will not be able to register any disposal of the property if it has not complied by the expiry of the 18 month permitted transitional period.

4.3 United States (“US”)

On December 11, 2020, and by a veto-proof majority, the US Senate joined the House of Representatives in passing the National Defense Authorization Act for Fiscal Year 2021, which includes the Corporate Transparency Act (the Act). The Act requires a report be filed with the Financial Crimes Enforcement Network (FinCEN) that identifies each beneficial owner of an applicant forming a reporting company. While questions remain as to the full implications of the Act, it represents an important step in the right direction for the United States in the battle against money laundering and terrorist financing.¹²

¹² <https://www.step.org/industry-news/us-congress-approves-act-requiring-companies-reveal-ownership>

Reporting Company

A *reporting company* is defined as a corporation, limited liability company or other similar entity that is created by filing a document with the secretary of state (or an equivalent office) of any state or formed under foreign law and registered to do business in the United States in a like manner. The Act exempts many categories of companies from the reporting requirement, specifically:

- Companies that are already subject to supervision or otherwise closely regulated by the federal government (e.g., banks)
- Dormant companies
- Companies that employ more than 20 people, filed a tax return reporting gross receipts in excess of \$5 million, and have a physical presence in the United States
- Any entity owned by an entity otherwise exempt

Definition of Beneficial Owner and/or an Applicant

A *beneficial owner* is defined as an individual who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise (i) exercises substantial control over an entity or (ii) owns or controls at least 25% of the ownership interests in an entity. A few notable exceptions from the Act include:

- Minors, provided that information with respect to a parent is otherwise reported
- An individual acting as nominee, intermediary, custodian, or agent on behalf of another individual
- Persons who control an entity solely because of their employment
- An individual whose only interest in a reporting company is through a right of inheritance

An *applicant* is defined broadly as an individual who files an application to form an entity.

CDD and Reporting Requirements

The report shall include the name, date of birth, current address (business or residential) and unique identifying number from an acceptable document for each beneficial owner and/or an applicant, with an option for such individuals to request and use a FinCEN unique identifying number instead. Existing entities will be required to report this information within two years of the effective date, which regulations promulgated within one year of enactment will determine. The report will be required for newly formed entities at the time of formation. Finally, a reporting company will need to update the information provided to FinCEN upon a change in beneficial ownership.

Information Storage and Access

FinCEN will store the information received pursuant to the Act in a private database not accessible to the public. The information will be made available to Federal and state law enforcement agencies pursuant to an appropriate request—state law enforcement requests require court approval. The Department of the Treasury, the custodian of the records through FinCEN, has its own broad and separate authorization to use the information, including for purposes related to tax administration. Foreign law enforcement also may request information from the database

through an appropriate agency of the federal government—but the information will not be subject to any automatic reporting or exchange of information. Finally, financial institutions will have access to the database for customer due diligence purposes.

Customer due diligence requirements for financial institutions will be updated to conform to the requirements of the Act and to consider access by financial institutions to the information compiled under the Act. This means that the establishment of any entity account with a financial institution likely will require compliance, by the entity, with the Act—providing a practical barrier to non-compliance.

Penalties for Non-Compliance

The willful failure to provide complete and/or updated information required under the Act or willfully providing false or fraudulent information carry steep civil and criminal consequences. Violations carry civil penalties of up to US \$500 per day that the violation continues and criminal fines up to US \$10,000 and/or imprisonment for up to two years. The obligations under the Act apply to beneficial owners and to applicants. The unauthorized disclosure of information collected under the Act carries the same civil penalty but a higher criminal penalty of up to US \$250,000 and a higher maximum term of imprisonment of five years. Unauthorized disclosure includes both a disclosure by a government employee and a disclosure by a third-party recipient of information under the Act.

5. RECOMMENDATIONS

The following recommendations are prescribed for improving measures to combat the use of legal entities to conduct money laundering:

- Eliminate the beneficial ownership requirement so that there is no *de minimis* percentage and all beneficial owners are captured;
- Establishment of a beneficial ownership register for a wide variety of assets (art, real estate, etc.) that includes overseas entities that own any reportable assets in these respective countries;
- Establishment of beneficial ownership registers for legal persons, that are digitalized, and required to be updated whenever there is a change in ownership or control, and that these be accessible;
- Ensuring that the beneficial ownership registers are accurate and easily accessible and searchable by the public;
- Establishment of an e-notary system digitizing notarized contracts and agreements;
- Enhanced communication and exchange of information among banks and the financial regulators;
- Exploring Private Public Partnerships to ascertain risks, detect illegal use of corporate vehicles and return stolen assets hidden domestically and abroad;
- Training for investigative authorities and anti-money laundering and compliance officers on beneficial ownership and the use of corporate vehicles for money laundering in other jurisdictions.

REFERENCES

- i)** Financial Action Task Force, Best Practices on Beneficial Ownership for Legal Persons, 2019 < <https://www.fatf-gafi.org/media/fatf/documents/Best-Practices-Beneficial-Ownership-Legal-Persons.pdf> >

- ii)** Financial Action Task Force, International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation. The FATF Recommendations (2012 - Updated October 2020) < <https://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf> >

- iii)** Financial Action Task Force (FATF), Concealment of Beneficial Ownership, 2018 < <https://www.fatf-gafi.org/media/fatf/documents/reports/FATF-Egmont-Concealment-beneficial-ownership-annex-E.pdf> >

- iv)** Transparency and Beneficial Ownership, 2014 < <http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-transparency-beneficial-ownership.pdf> >

