GRAVE SECRECY

A BRIEFING PAPER BY GLOBAL WITNESS, JUNE 2012

global witness

Global Witness is a UK-based non-governmental organisation which investigates the role of natural resources in funding conflict and corruption around the world.

References to 'Global Witness' in this report are to Global Witness Limited, a company limited by guarantee and incorporated in England (Company No. 2871809)

Global Witness,
Buchanan House,
30 Holborn,
London, EC1N 2HS.
mail@globalwitness.org

CONTENTS

RECOMMENDATIONS

Grave Secrecy details a complex story of companies with hidden ownership and suspicious financial transactions, with accounts at a Kyrgyz bank that has been at the centre of major money laundering allegations. The story shows how companies in general can be used as cover to launder the proceeds of corruption, tax evasion and other crimes. This should not be possible.

Global Witness has come up with a number of recommendations on how to prevent such abuses from occurring. The recommendations below are ordered according to the body to which they are addressed. The same recommendations are presented throughout this report, ordered according to the problem they are designed to overcome.

Countries

- National corporate registries should carry out due diligence, on a risk based approach, to verify that the beneficial ownership information provided to them is correct. This need not be that onerous: company service providers are already required by the global anti-money laundering standards to do exactly this. The fees charged on incorporation could be increased in countries where they are currently low to cover the extra costs this would entail.
- Serious penalties should be imposed on company officers who provide false information or fail to provide legally-required information, so that nominees think twice about pimping their identity to people whose business they do not really understand. In particular, the UK should investigate the nominee directors and companies they work for that are named in Grave Secrecy for potential breaches of the Companies Act.
- Countries should ensure that the company filing requirements are enforced, by imposing fines on, or prosecuting, company directors who file to provide the necessary information.
- Those countries that do regulate company service providers under their anti-money laundering laws should make significantly greater efforts to ensure that these standards are enforced.
- Countries that do not regulate company service providers under their anti-money laundering laws should do so, with criminal penalties for the worst failures.
- Countries should put pressure on the secrecy jurisdictions with which they have relationships (for example, the UK and its Overseas Territories and Crown Dependencies) to adopt a standard of publicly available shareholder registries.
- The global anti-money laundering rules require company service providers to obtain identification documents of the beneficial owners of companies that they create. National corporate registries should be required to do the same, for both the owners and directors of companies.

European Union

The body that sets the global anti-money laundering standards, the Financial Action Task Force, updated its standards in early 2012.[1] As a

consequence of this, the European Union is in the process of updating its anti-money laundering directive. Once it is in place, all EU member states will be required to update their national legislation.

- The EU should require member states to have publicly available legal shareholder registries.
- The EU should require member states to have publicly available beneficial ownership registries.
- The EU should require member states to require directors to state whether they are nominees and say on whose behalf they are working. The information should be made public by national corporate registries. The World Bank has already recommended such action.[2] And the global anti-money laundering body, the Financial Action Task Force, has recently stated that countries should 'consider' requiring nominees to declare themselves as such and say on whose behalf they are working.[3]
- The EU should clarify that company service providers are required to do customer due diligence even if not providing any further services beyond setting up a company.

Financial Action Task Force

- FATF should use its country evaluations not just to assess if laws are on the books, but to assess whether they are being enforced. It should put much more pressure on those countries not in compliance with its standards. One way of starting the ball rolling on this would be for all mutual evaluations, which are often hundreds of pages long, to include a summary with the various recommendations put in order of priority.
- FATF should penalise countries that have failed to regulate company service providers under their anti-money laundering laws.
- FATF should require countries to have publicly available beneficial ownership registries.

The real owners of companies can hide their identities behind legal structures. (Credit: Mortal Coil Media)

"Almost every economic crime involves the misuse of corporate vehicles [i.e. companies and trusts]"
OECD, 2001[4]

INTRODUCTION

Global Witness' new report, *Grave Secrecy*, shows how companies can be used as cover to launder the proceeds of corruption, tax evasion and other crimes. It is so easy to set up a company in a way that hides the owner's identity that criminals, terrorists and corrupt politicians can easily move money around the world with impunity. **Hidden company ownership** facilitates state looting, denying the citizens of poor countries the chance to lift themselves out of poverty and leaving them dependent on aid.

In one example from the report, we found that a Russian shareholder of a UK company died three years before the company was incorporated with someone apparently using his identity to move US$700 million around the world. Such examples show how it is possible to set up a company in the UK (and elsewhere) without even the most basic of checks being carried out on the identities of the supposed owners.

The case examined in *Grave Secrecy* focuses on a Central Asian bank at the centre of major money laundering allegations. Kyrgyzstan's largest bank, AsiaUniversalBank (AUB), was nationalised and found to be insolvent after a revolution overthrew the regime of President Bakiyev in April 2010. The new Kyrgyz authorities claim that AUB was engaged in large scale money laundering and an independent audit funded by the European Bank for Reconstruction and Development has backed this up.

However, the bank's former management claim that the new regime's claims against them are politically motivated.

In an attempt to get beyond these contradictory claims, Global Witness investigated dozens of companies that held accounts at AUB, many registered in the UK, and found significant indicators of money laundering, including:

- Hundreds of millions of dollars were moving through the companies' accounts while they appeared not to be engaged in any real business activity.
- Many of the transactions look like payments for goods between companies trading with each other in the open market but are in fact between companies that are related to each other. This raises the possibility that the money was not being used to buy goods, but being moved around for money laundering purposes.

The suspicious activity carried out by just three of these shell companies with accounts at the bank appears to have run to US$1.2 billion, more than a quarter of Kyrgyzstan's GDP.

This briefing document examines the factors that allowed these events to happen, most of which involve methods for hiding the ownership and control of companies. We use this analysis to make recommendations as to how to prevent such problems in the future. The factors we look at are:

1. Secret shareholder registries
2. Lack of information on beneficial ownership
3. Hiding the identity of the real owner using nominee directors and shareholders
4. Lack of due diligence by company service providers
5. Lack of verification of information by national corporate registries

1. SECRET SHAREHOLDER REGISTRIES

WHAT IS A SECRECY JURISDICTION?

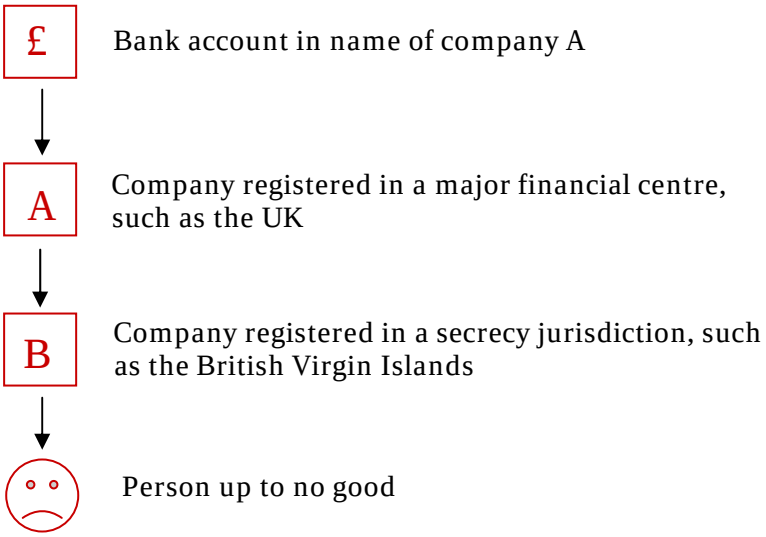
Secrecy jurisdictions are often thought of as being 'sunny places for shady people' – places like the British Virgin Islands, The Marshall Islands and Vanuatu. One of the things that makes such places secret – although not the only one – is that they lack open shareholder registries. This makes it impossible to find out who owns the companies that are registered there (law enforcement agencies can find this information, though it is often very difficult for them, as described below). Sometimes they are a referred to as tax havens, though Global Witness prefers the term secrecy jurisdiction as such places do not just offer a way of avoiding tax but also offer the ability to hide your identity for other purposes, including corruption and other illegal activity. As described below, any company can have a parent company registered in a secrecy jurisdiction, making it easy to hide the ownership of any company, anywhere.

What is the problem?

Nobody intending to launder money attempts to do so by opening bank accounts in their own name these days. Instead, they open an account in a company's name and ensure that it is extremely difficult to find out who is behind the company.

There are two main ways of doing this: registering the company or the parent company in a secrecy jurisdiction (which we address in this section), and using nominee shareholders to disguise the real owners (which we address in the next section).

Registering a company in a secrecy jurisdiction, and thus hiding who owns it, could, to some observers, make the company appear suspicious. However there is an easy way around this: set up a company in a major financial centre – somewhere with an open shareholder registry, such as the UK – but ensure that this company is in turn owned by companies that are themselves registered in secrecy jurisdictions. So it looks reputable on



It can be easier to set up anonymous companies in the US than in more traditional 'offshore' centres such as the Cayman Islands. (Credit: Todd Wickersty/CC)

the surface, but the owner is still, in reality, hidden. This makes the distinction between what are typically thought of as being 'offshore' and 'onshore' jurisdictions break down: it is extremely easy to hide the ownership of companies wherever they are incorporated, and all jurisdictions, whether 'onshore' or 'offshore, are effectively part of this global system of secrecy.

In addition, even the supposedly 'onshore' jurisdictions are not as open and transparent as people often assume. The World Bank reviewed 150 big cases of corruption between 1980 and 2010 and identified the companies that were used to hide peoples' identities. Companies registered in the United States topped the list, with 102 out of the 817 companies.

The US is not often thought of as being a secrecy jurisdiction, but in fact not a single state requires ownership information to be made public at the time companies are formed,[5] and Delaware does not even collect any ownership information let alone publish it (and of course as it does not have the information, cannot make it available to law enforcement).

Even governments which claim to want to be more transparent, effective and accountable – the 55 countries of the Open Government Partnership all claim this – are not doing very well on making even the most basic of company details available. The information provision group OpenCorporates scored each country on six criteria, including whether information on directors and shareholders is available and whether it is possible to carry out free searches online.[6] The average score of the Open Government Partnership countries was just 21 out of 100, even though the criteria against which they were being judged were pretty basic. Several major countries, including Spain, Greece and Brazil, scored zero, meaning no company information is available at all without payment or registration. Increasing corporate accountability is one of the Open Government Partnership's five 'grand challenges'.

Countries that do not publish information on the owners of companies incorporated under their laws typically argue that this is not a problem as, through mutual legal assistance or tax information exchange treaties, they make such

information available to the relevant authorities. However there are a number of problems with this:

1) Law enforcement and tax authorities are not allowed to go on 'fishing expeditions'; they can only ask specific questions about companies they have reason to be concerned about. There's a *catch-22* here: they have to know what they are looking for, but the secrecy laws themselves make this very difficult.

2) It takes a long time to get information out of any one jurisdiction. The networks of companies that are used to launder money are deliberately layered to hide various clues to ownership and control in different nations, meaning that law enforcement has to spend a lot of time and money getting information out of various jurisdictions. The assistance obtained through 'mutual legal assistance treaties' used by law enforcement to obtain information from other countries is generally time-consuming and even in the best cases can take several months. There have been some cases where pieces of evidence were finally provided long after a trial had been completed.[7] The money held by these structures is often long gone by the time the real owner is finally revealed. In *Grave Secrecy*, the companies that made the suspicious money transfers were often dissolved before anyone knew what was going on.

3) Companies cannot find out who is behind the firms that they are dealing with. This often makes it impossible for companies to know who they are doing business with, or who they are setting up in business with, which can present a risk to companies. For example the US oil firm Cobalt International Energy entered into partnership with two local Angolan companies called Nazaki Oil & Gaz and Alper Oil to explore for oil in Angola.[8] In April 2012, it was revealed that Nazaki was owned by senior Angolan officials.[9] The ownership of Alper remains hidden, because it is possible in Angola to set up an 'anonymous company' where shareholders' details are not published. Cobalt is being investigated in the United States under the Foreign Corrupt Practices Act in relation to its dealings with Nazaki, although it denies any allegation of wrong doing.

4) Banks and other institutions are (or should be) required by anti-money laundering regulations to know their customers. If a company registered in a secrecy jurisdiction wants to, say, open a bank account then the bank has little option but to ask the company in question who their ultimate shareholders are; if the company in question is up to no good, then it is all too easy for them to provide false information.

5) The general public and parliamentarians cannot find out who owns or controls companies, and therefore cannot hold companies to account. For example, see the boxes on pages 8 and 11 on Congo's minerals and Zimbabwe's diamonds.

How does this work in practice?

Grave Secrecy details how companies which were registered in the UK each had a shareholder in the British Virgin Islands, a secretary in the Marshall Islands and a director in Panama. The British Virgin Islands does not publish any information about who owns or runs companies and therefore the real owner of these UK companies is kept hidden. For more examples of how secret shareholder registries are a problem, see the boxes at the end of this section.

What should be done about it?

Information on who legally owns companies should be open for all to see. The global anti-money laundering rules require *countries* to

maintain registries of companies, and require *companies* to maintain a list of their shareholders.[10] But this does not go anywhere near far enough. Lots of countries make shareholder information public; there is no reason why the others cannot.

- The EU should adopt a standard of publicly available shareholder registries in each of its member states as part of its review of its Third Anti-Money Laundering Directive.
- EU states should put pressure on the secrecy jurisdictions with which they have relationships (for example, the UK and its Overseas Territories and Crown Dependencies) to do the same.

HIDDEN COMPANY OWNERSHIP AND THE PROFITS FROM CONGOLESE COPPER AND COBALT[11]

Congo - a desperately poor, war-ravaged country - is losing out on billions of dollars of revenues because the Congolese state is getting very little in return for many of its best copper and cobalt mines. Instead, the vast majority of the profits are going into the hands of unknown people. Since early 2010 the Congolese state has sold off stakes in six prize mining projects - in secret and at vastly undervalued prices. The immediate buyers of these mining assets were predominantly companies in the British Virgin Islands. Some of the mining stakes were sold on soon after to the FTSE-100 company, ENRC, for much higher amounts. Someone pocketed a fortune, but due to the fact that the British Virgin Islands does not make legal shareholder owner information available, let alone beneficial owner information, the Congolese people have no means of knowing who has benefited from these secret deals.

HIDDEN COMPANY OWNERSHIP AND ASSET RECOVERY CASES

In March 2012 Libya successfully recovered a £10 million London house which previously belonged to Colonel Gaddafi's son, Saadi Gaddafi.[12] The High Court in London ruled that the property, in the up-market London suburb of Hampstead, rightfully belongs to the Libyan state as it had been purchased with diverted Libyan state funds. The house was owned by a British Virgin Islands company, Capitana Seas Limited. This judgement was the first and so far only successful asset recovery case brought by Libya. Very few stolen assets are returned to their rightful owners: the World Bank's Stolen Asset Recovery Initiative estimates that less than one percent of assets stolen in the last ten years have been recovered. The ability to hide assets via companies registered in secrecy jurisdictions significantly hinders such asset recovery cases.

Saadi Gaddafi's £10 million London mansion was owned by a British Virgin Islands shell company. (Credit: Global Witness)

2. LACK OF INFORMATION ON BENEFICIAL OWNERSHIP

WHAT IS BENEFICIAL OWNERSHIP?

It would be reasonable to assume that if you looked up the shareholders of a company in its national corporate registry that you would have found the list of people who own the company; those who control it and benefit from any profits that it might make or any share dividends it might pay out. But this is not necessarily true as the people listed in the corporate registry are the *legal owners* of the company, who are often not the same as the people who enjoy the benefits of the company, the *beneficial owners*. In other words, the legal title to a company may not be in the name of the person who actually controls it. This may happen in three ways:

1. 'Nominee' shareholders may be listed on the corporate registry. We address this issue in the section below.
2. The legal owner of the company might be another company (or trust or foundation, which can be even more opaque than companies), usually in another jurisdiction.
3. The beneficial owner of a company may ask someone else, typically a relative, business associate or trusted friend, to front the company for them, in order to hide their involvement in the company.

What is the problem?

While it may be difficult to get hold of information on the legal owners of a company, as described in the section above, it is even more difficult to get hold of information on the beneficial owners of a company. The World Bank has stated that corporate registries around the world 'sometimes' collect information on the legal owners of companies but 'very rarely' collect those of the beneficial owner. This work was based on a review of 40 company registries in relevant jurisdictions around the world.[13]

And yet it is the beneficial owners of a company that are relevant for anti-money laundering purposes. The global anti-money laundering standards require banks and other institutions to identify the real, beneficial owners of accounts, since without this information they cannot meaningfully assess the risk of the money deposited being the proceeds of crime. Crucially, the global anti-money laundering standards also require governments to take measures to prevent the unlawful use of 'legal persons' – i.e. companies – by money launderers. Countries are supposed to do this by making sure that information is available on the beneficial owners of companies incorporated under their laws and to always identify the beneficial owners. However, there are two problems with this:

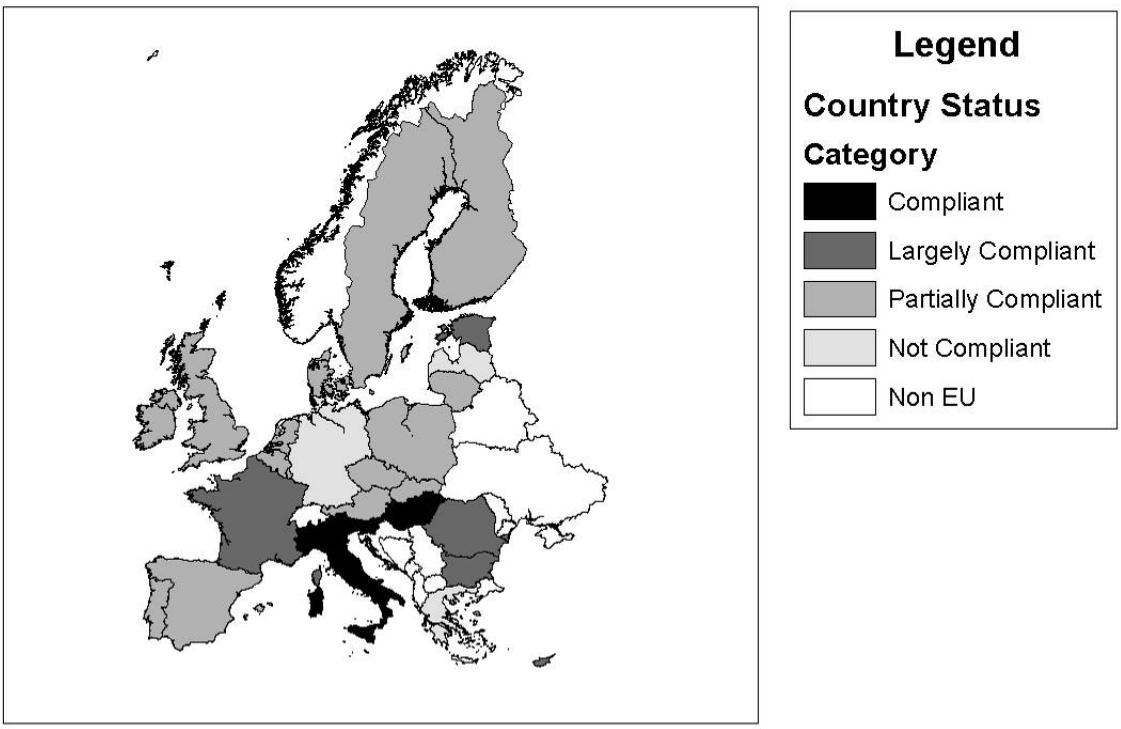
1) Lots of countries do not comply with this standard. The Financial Action Task Force (FATF) carries out 'mutual evaluations' of countries to assess their degree of compliance with the global anti-

money laundering standard. Of the 34 countries that are FATF member states an astonishing 30 were deemed to be 'not compliant' or 'partially compliant' with this particular recommendation, as of their last FATF evaluation. Countries that are 'not compliant' include the US, Canada, Germany and Switzerland. (See map below, and the appendix for full details of the findings.)

2) The anti-money laundering requirements on beneficial ownership do not go far enough. FATF's recommendation on beneficial ownership requires that countries, as a minimum, make beneficial ownership information available to competent authorities such as law enforcement.

It is possible to do this with no registry whatsoever – you just leave it up to law enforcement to do what they can with existing sources of information. But while this may contribute to law enforcement efforts once money has already been laundered or other crimes already committed, it does nothing to prevent the misuse of front companies in the first place. Objections to more openness over beneficial ownership frequently centre on the cost to business or 'red tape' fears, which is usually a concern about the impact on small and medium businesses. But most small and medium enterprises do not have difficulty in knowing who their beneficial owners are, meaning that it is not a burden to provide this information in addition to the other information they must already provide.

Those who set up the complex multi-jurisdictional structures in which beneficial ownership is separated from legal shareholding tend to be bigger companies, or wealthy individuals, seeking to avoid tax in the place they live or do business. They pay large fees to lawyers to set up such structures, and so it would not be difficult to instruct the lawyers to make the information available in the jurisdiction where each element of the structure is incorporated.



Map showing the extent to which EU countries are compliant with the FATF recommendation on beneficial ownership. (Source: FATF mutual evaluations)

How does this work in practice?

Grave Secrecy details allegations by the Kyrgyz authorities that both the former president's son and the chairman of the bank were behind some of the companies with suspicious transactions. This allegation cannot be verified because it is not possible to find out who the beneficial owners of the company are, but warrants further investigation by the authorities of the countries where these companies have been registered. For another example of how the lack of information about beneficial ownership can be a problem, see the box at the end of this section.

What should be done about it?

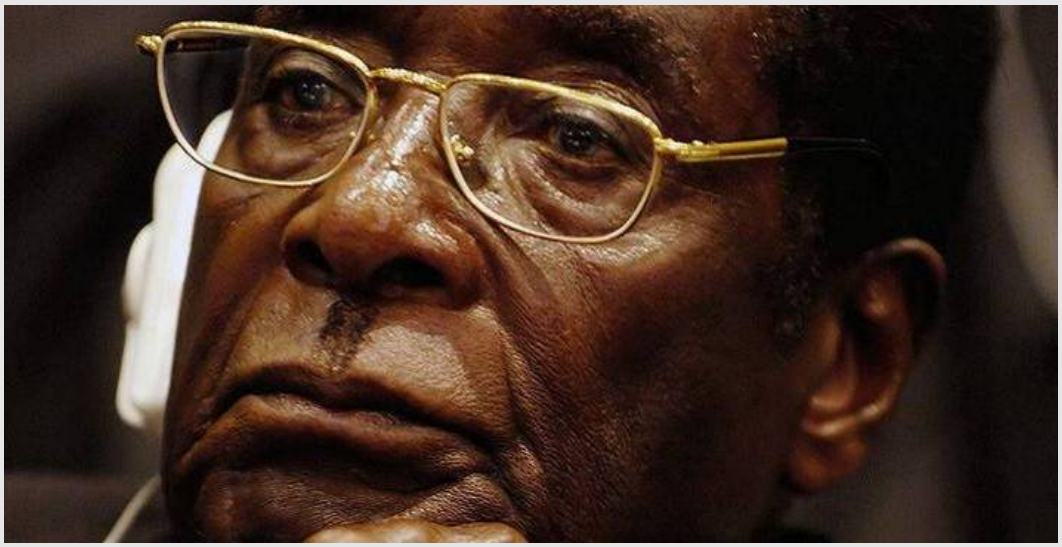
Countries should not only publish the legal owners of companies, but should also collect, verify and publish the names of the beneficial owners of companies. Such beneficial owners should be actual people, not a further layer of companies or trusts.

In particular:

- The EU should adopt a beneficial ownership registries standard as part of its Fourth Anti-Money Laundering Directive.
- FATF should adopt this same standard as its level of compliance for Recommendation 24 at the earliest possible opportunity. (Though note that FATF spent the last two years reviewing its standards, including the ownership information that countries should require from companies incorporating in their jurisdiction, and missed the opportunity to require countries to make information about the beneficial ownership of companies public.)

HIDDEN COMPANY OWNERSHIP AND ZIMBABWE'S DIAMOND FIELDS[14]

In 2008 the Zimbabwean army took control of the country's Marange diamond fields using troops and helicopter gunships, killing and wounding many small scale miners in the process. Since then diamond mining concessions have been allocated to several companies with hidden ownership. For example, Global Witness' investigations revealed that Mbada Diamonds is partly owned by a complex web of intermediate companies registered in the British Virgin Islands, Hong Kong and Mauritius, connected to a former Air Vice Marshal in the Zimbabwean military. What is impossible to find out, however, is who ultimately behind these companies.



The ownership of some Zimbabwean diamond concessions is hidden behind a web of offshore companies in Hong Kong, the British Virgin Islands and Mauritius. (Credit: USAF)

3. HIDING YOUR IDENTITY USING NOMINEE DIRECTORS AND SHAREHOLDERS

WHAT ARE NOMINEE DIRECTORS AND NOMINEE SHAREHOLDERS?

It is perfectly legal in many countries to avoid having your name appear as the director or owner of a company by employing the services of a nominee, whose name appears instead. Nominees are, in essence, renting out their name, and in doing so, providing the anonymity that corrupt officials, tax evaders and other criminals require to move dirty money around the world.

What is the problem?

While it may be possible in those countries that have open registries to obtain names of the legal owners and directors of a company, it is almost impossible to tell whether the names recorded on the registry are the people who actually own and run the company, or whether they are nominees.

The use of nominees hides the names of the people who actually own or run the company – something that is hugely useful for money launderers. Indeed, some companies that provide nominee services even advertise the fact that you will be able to set up a company anonymously. For example, GT Group, which set up some of the companies named in *Grave Secrecy* once advertised that "[Geoffrey Taylor] can act as Director and Shareholder for clients without arousing suspicion that he is a nominee only. In this way he can act as your front man and attract attention away from you."[15]

And yet lots of countries allow the use of nominees. The World Bank, as part of the report, *Puppet Masters: how the corrupt use legal structures to hide stolen assets and what to do about it*, surveyed 37 jurisdictions (some countries, some, in the case of the US, individual states) to determine whether nominee directors are permitted.[16] Results were obtained for 34 of the 37 jurisdictions; all but one allow companies to use nominee directors. This includes the UK and all of the surveyed US states. For the full results see the table in the appendix.

Some people act as nominee directors for so many companies that they cannot possibly provide any sort of meaningful oversight to all of them. Being a director (or nominee director) does not just require sending off forms to the corporate registry, it requires a knowledge of the company so that you can be sure that the information on such forms is correct. The fact that nominees are happy to take on this business in such volumes demonstrates they do not fear any meaningful penalty for breach of the Companies Act if wrong-doing by the companies' real owners is discovered. Enforcement of the law needs to be tightened.

How does this work in practice?

Grave Secrecy details how:

- several UK companies involved in suspicious transactions in Kyrgyzstan did not provide information to the UK corporate

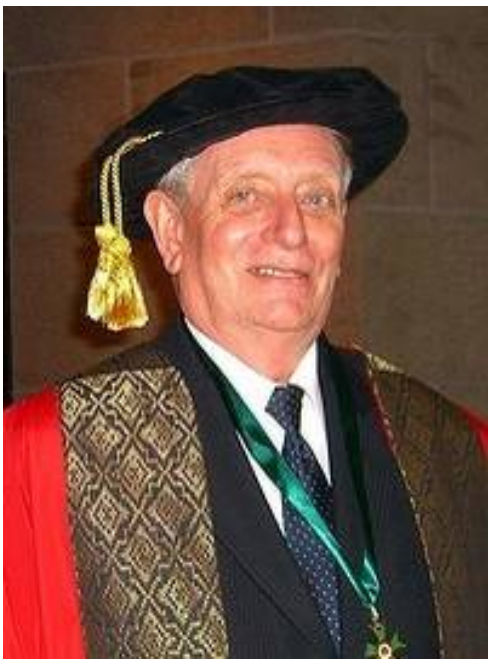
registry that they are required to do by law, such as providing annual reports;

- two UK companies declared they were dormant when, in fact, hundreds of millions of pounds were flowing through their bank accounts.

All of these companies had nominee directors. A number of the nominee directors contacted by Global Witness claimed that they are 'only' nominees; that they had no knowledge of what the companies they 'direct' were doing, and therefore cannot be held responsible for their actions. One even sent us a document purporting to be an indemnity from the beneficial owner(s) from any consequences of misstatement.

This raises a question as to who bears legal responsibility for a company that uses nominee directors. The answer is clear. Under the 2006 Companies Act in the UK, directors are personally liable for breaches of statutory and administrative duties, and this applies whether the directors are nominees or not. Administrative duties include the duty to keep statutory records up to date and file annual reports, which includes filing reports with the UK corporate registry on whether the company is dormant. Of course, such information is also required to be accurate; the nominee directors of two UK companies named in *Grave Secrecy* stated that the companies were dormant when millions of dollars were passing through their bank accounts.

Directors and company secretaries can be convicted of an offence and fined for such failings. In practice, however, there are very few consequences for



Geoffrey Taylor's GT group advertised that he could act as a "front man" drawing attention away from the client. (Credit: Geoffrey Taylor website)

nominee directors because these provisions of this act are not effectively enforced, either on 'real' directors or nominees. Until they are, there will continue to be a massive loophole in UK company law whereby directors' legal responsibilities can be avoided by employing nominees who deny any knowledge of the companies' activities.

For another case study of how nominees can be a problem, see the box at the end of this section.

What should be done about it?

Nominee directors should be required to identify themselves, *and* be held responsible for the actions of the company. This is a key aspect of preventing companies being misused for money laundering. Countries should actively enforce their company

"I live with my little baby in a small town in the interior of the country and I have no job, no work for anyone, I've only been a nominal head these corporations."

A nominee director of seven companies named in *Grave Secrecy*

laws requiring accurate filing of accounts, and hold nominee directors to a standard of responsibility which does not permit them to claim ignorance of the activities of the company they purport to direct.

- As part of its current review into its Third Anti-Money Laundering Directive, the EU should require member states to require directors to state whether they are nominees and say on whose behalf they are working,. The information should be made public by national corporate registries. The World Bank has already recommended such action.[17] And the global anti-money laundering body, the Financial Action Task Force, has recently stated that countries should 'consider' requiring nominees to declare themselves as such and say on whose behalf they are working. [18]
- Serious penalties should be imposed on company officers who provide false information or fail to provide legally-required information, so that nominees think twice about pimping their identity to people whose business they do not really understand. In particular, the UK should investigate the nominee directors and companies they work for that are named in *Grave Secrecy* for potential breaches of the Companies Act.

NOMINEE SHAREHOLDERS AND THE TRANSPORT OF GAS FROM CENTRAL ASIA TO EUROPE

An elderly Romanian actress legally owned a company that transported gas worth millions. She did it to pay her phone bill. (Credit: Global Witness)

Billions of dollars of natural gas are transported each year from the Central Asian country of Turkmenistan through Russia and the Ukraine and to Europe. For years, it was not clear who controlled this trade. Global Witness published a report, *It's a Gas*, on the mysterious intermediary companies that were used to transport the gas in order to highlights how nominee shareholders were used to hide the identities of the people benefiting from the trade.

One such company, Eural Trans Gas, that made millions transporting gas to Ukraine was legally owned for a time by an elderly Romanian actress who said she got involved with the company in order to pay her phone bill.[1] Later the shareholding structure was changed and involved an array of companies registered in the Seychelles, Austria and Cyprus. [1] These companies were used to obscure the identity of the real owner, who was later revealed to be a Ukrainian oligarch.[1] Europe's energy security should not be left in the hands of such opaque companies.

4. LACK OF DUE DILIGENCE BY COMPANY SERVICE PROVIDERS

WHAT ARE COMPANY SERVICE PROVIDERS?

Company service providers are companies that set up and help run other companies. The services they provide include:

- acting as a formation agent of companies;
- acting as (or arranging for another person to act as) a nominee director or shareholder. Such nominees are often, but not always, employees of the company service provider;
- providing a registered office, business address;
- providing on-going secretarial or administrative services, such phone answering, mail forwarding or book-keeping.

What is the problem?

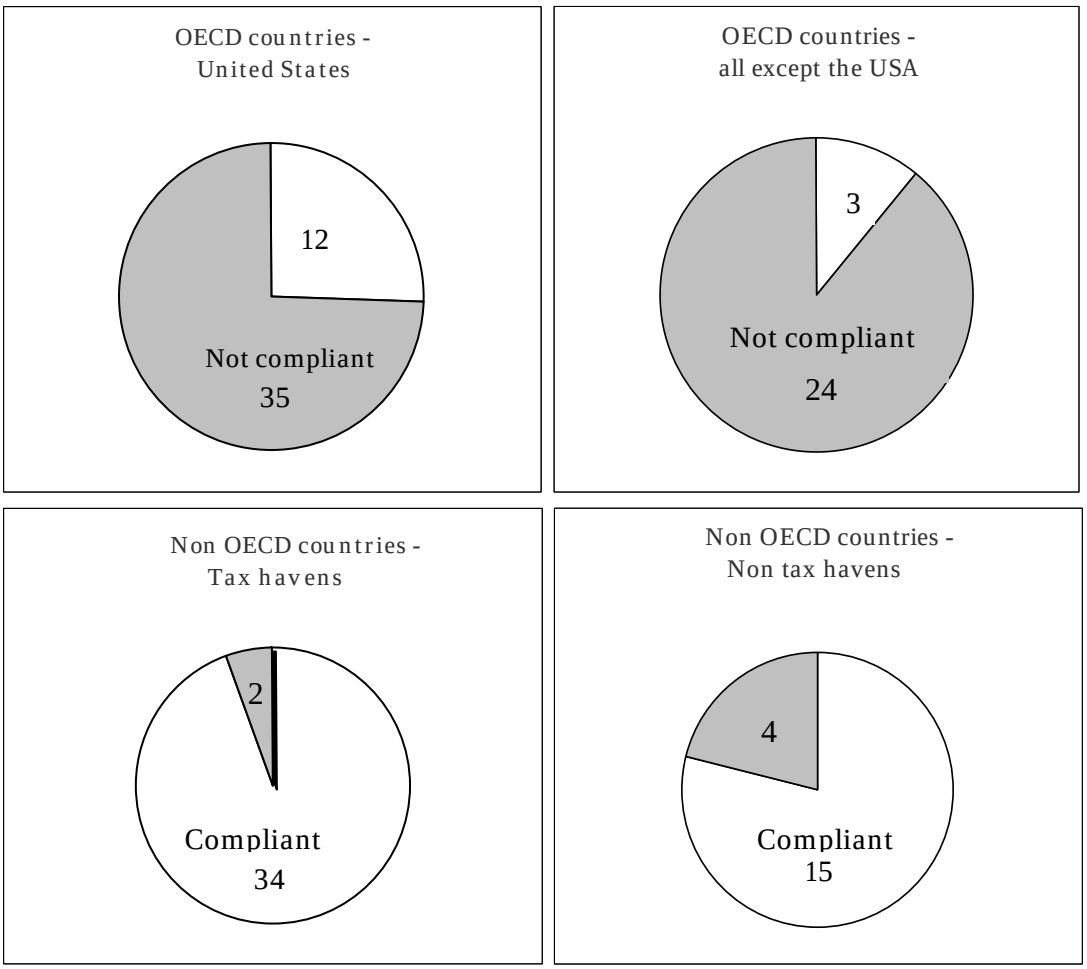
The global anti-money laundering standards require company service providers that set up companies and that act as nominee directors, shareholders and company secretaries to know whom they are acting for and to report any suspicions they have about these businesses to the authorities.[19] In other words, company service providers are supposed to identify beneficial owners, identify people at high risk of corruption who therefore require enhance due diligence, identify the source of their clients' funds, and file suspicious activity reports to the authorities if necessary.

But there are a number of problems with this:

1) **Some countries have not incorporated this aspect of the global anti-money laundering requirement into law.** Some countries, including the USA, Russia and New Zealand do not regulate their company service providers in any way (although new regulations due to come into force in New Zealand in June 2013 will require company service providers to identify the beneficial owners of their customers and file suspicious activity reports).

2) **The laws are often not enforced**. The Financial Action Task Force evaluates countries' compliance with their anti-money laundering recommendations. With regard to the recommendation to regulate company service providers to ensure they do due diligence on their clients no EU countries are 'compliant'; only two are 'largely compliant'; and some of the major EU economies including France, Germany, Italy and Spain, are 'not compliant'.[20]

   The results are particularly shocking given that FATF's evaluations primarily examine whether a country has laws in place to abide by each of its recommendations, and only patchily examine whether those laws are effectively enforced. In other words even those few countries in the EU which did not receive the worst rating may not be



Results of the World Bank/UNODC survey into whether company service providers comply with the FATF anti-money laundering recommendations. Grey indicates non-compliance with respect to asking for proof of ID of the beneficial owner; white indicates compliance.

doing as well as the map below implies. The global anti-money laundering standards require company service providers to report any suspicious activity they encounter to the relevant national authority. Yet, at least in the EU, hardly any such 'suspicious activity reports' are submitted by company service providers.

In the UK, 0.02% of the total number of suspicious activity reports filed in 2007 (the latest year for which figures are available) were submitted by company service providers.[21]

3) **There is a legal loophole in the UK's requirements of company service providers**. In the UK, company service providers have to identify their clients, establish their source of funds, monitor ongoing relationships and report any suspicious activity. However, they do not have to do any of this if they set up a company but do not provide any subsequent services. A number of the companies Global Witness has examined fall into this category: set up by a UK company service provider but with nominee shareholders and directors in the

Company service providers often don't comply with anti-money laundering standards

People named on company registries may not be the actual owner or managers

Seychelles, Russia or Panama, meaning that the UK provider who registered the company does not have any anti-money laundering responsibilities. Add a bank account in a jurisdiction that does not enforce customer due diligence requirements on its banks – and you have the perfect money laundering arrangement.

The UK's company service provider regulator, HMRC, told Global Witness that both it and the Association of Company Registration Agents agreed that the setting up of a company by itself is viewed as a one-off event and therefore not subject to anti-money laundering corporate due diligence.[22] Indeed, this point was cited by one of the service providers named in *Grave Secrecy* when Global Witness asked what due diligence it had done on its clients.

Yet as seen above, the global anti-money laundering standard is that company service providers should be covered by anti-money laundering regulations including when 'acting as a formation agent of legal persons', i.e. setting up a company.

Requiring company service providers in the UK to carry out due diligence on their customers no matter the length of their relationship with them would not be enough to close this loophole.

This is because it is possible to set up a company in the UK directly with Companies House, without going through a company service provider, and Companies House itself does not carry out any customer due diligence on people setting up UK companies. The need for corporate registries to verify information is discussed in the next section below.

How does this work in practice?

The World Bank and UNODC's Stolen Asset Recovery Initiative anonymously approached company service providers to test whether they would abide by the FATF anti-money laundering recommendations. Emails were sent to 217 company service providers. The emails were designed to set off money laundering 'red flags'; they stressed the need for confidentiality and tax minimisation. 102 company service providers replied, of which an alarming 40% were prepared to set up a company without any documentation to verify the identity of the beneficial owner – a key component of the FATF recommendations. The results showed that, contrary to common perception, company service providers in rich, OECD countries were less likely to comply with the recommendations than those in secrecy jurisdictions (see graphs on left, and full results in the appendix).

Grave Secrecy documents numerous companies involved in suspicious transactions which were set up by UK and Seychelles company service providers. Both of these countries regulate company service providers, but, as described below, do not do enough to ensure that the due diligence done by these firms is good enough.

The entity responsible for regulating company service providers in the UK is the UK's tax authority, HMRC. HMRC told Global Witness that it has yet to sanction any company service provider for non-compliance with

their due diligence requirements.[23] In the Seychelles, the organisation that is legally responsible for ensuring that company service providers comply with the anti-money laundering laws had not undertaken any onsite inspection visits at the time of its most recent evaluation as to whether it meets the FATF anti-money laundering recommendations.[24]

The offices of company service provider @UKplc in West Berkshire: the former registered address of one of the companies named in the report and over 15,000 other companies (Credit: Global Witness)

What should be done about it?

Company service providers should know whom they are acting for and to report any suspicions they have about these businesses to the relevant authorities. Regulators should ensure that all company service providers do this.

- Countries that do not regulate company service providers under their anti-money laundering laws should do so, with criminal penalties for the worst failures. FATF should penalise countries that have failed to do this.
- FATF should use its country evaluations not just to assess if laws are on the books, but to assess whether they are being enforced. It should put much more pressure on those countries not in compliance with its standards. One way of starting the ball rolling on this would be for all mutual evaluations, which are often hundreds of pages long, to include a summary with the various recommendations put in order of priority.
- Those countries that do regulate company service providers under their anti-money laundering laws should make significantly greater efforts to ensure that these standards are enforced.
- The EU should clarify that company service providers are required to do customer due diligence even if not providing any further services beyond setting up a company.

Company service providers file very few suspicious activity reports

5. LACK OF VERIFICATION OF INFORMATION BY NATIONAL CORPORATE REGISTRIES

WHAT IS A NATIONAL CORPORATE REGISTRY?

The global anti-money laundering rules require countries to keep a register of all the companies that have been formed in that country. The national corporate registry is the body that maintains such information and sometimes makes it public.

What is the problem?

Grave Secrecy highlights the shocking inadequacy of how some of the world's major economies monitor the registration and operation of companies. The problems encountered include:

1. Corporate registries do not verify information provided to them. A 2008 study showed how 1,504 disqualified directors were being allowed to run UK companies, as the UK corporate registry was not checking names against its own register of disqualified persons. The screening also revealed 13 individuals who are either wanted by Interpol for terrorism or associated with terrorist groups and activities and 37 narcotics traffickers.[25]

2. Corporate registries fail to follow up companies that fail to file accounts. All UK companies, whether trading or dormant, must provide a copy of their annual accounts to the UK corporate registry.[26] As described above in the section on nominees, not doing so is a breach of the UK Companies Act. The problem is that the UK corporate registry often fails to chase up companies that fail to file their accounts.

3. Companies are declared dormant when they are not.

How does this work in practice?

Grave Secrecy documents how a supposedly dormant UK company, whose AUB account saw about US$700 million flow through it in just under two years, was legally owned by a man who died before the company was registered. This highlights the problems of lack of verification by the UK corporate registry, which does not require a copy of the either the legal owner's passport or the beneficial owner's passport to be held on file, making it easy to set up companies with fake owners.

The accountant Richard Murphy showed that an astonishing 500,000 UK companies were dissolved in the

National corporate registries do not monitor the registration of companies

Kaluga, Russia: a dead man from this town became the owner of a UK company that documents show saw US$700 million pass through its account. (Credit: Wikimedia)

year to March 2010.[27] Most were not dissolved by the company directors themselves, but by the UK corporate registry because they had failed to file any accounts. Hidden within these half million are likely to be front companies used to launder money (as well as companies that have not paid their taxes). The UK corporate registry should investigate companies that fail to file accounts and the UK should fine company directors, whether nominee or not, for failing to file their accounts; and in the most vegregious cases such as those involving fraud, should prosecute.

What should be done about it?

National corporate registries need to verify the information that is provided to them. There are two parts to this: verifying that the beneficial owner is in fact a real person and verifying that they are the beneficial owner of the legal structure.

- The global anti-money laundering rules require company service providers to obtain identification documents of the beneficial owners of companies that they create. National corporate registries should be required to do the same, for both the owners and directors of companies.
- National corporate registries should carry out due diligence, on a risk based approach, to verify that the beneficial ownership information provided to them is correct. This need not be that onerous: company service providers are already required by the global anti-money laundering standards to do exactly this. The fees charged on incorporation could be increased in countries where they are currently low to cover the extra costs this would entail.
- Countries should ensure that the company filing requirements are enforced, by imposing fines on company directors who fail to provide the necessary information, and prosecuting those involved in the most egregious cases such as fraud.

CONCLUSION

Time and time again, Global Witness has showed that at the heart of corrupt dealings are companies with opaque ownership.

The original purpose of a limited liability company is in its name – to limit the personal liability of individuals going into business in order to promote enterprise and entrepreneurship. The mechanism by which companies do this – the creation of a 'legal person' separate from a 'natural person' – has a side effect: the ability to hide the real person behind the company.

Hidden ownership of assets has now become the main aim of vast numbers of companies in every corporate registry in the world. This means that limited liability companies are being abused for secrecy purposes on an industrial scale – not just by the corrupt, but by tax evaders, fraudsters, human traffickers, drug traffickers and terrorists.

By setting up a limited liability company, the state confers on you certain privileges, notably that the profits you can get from the company are unlimited whereas the losses you personally will have to bear if the company goes bust are limited to the size of your investment.

This privilege is granted by the state and so it is reasonable for the state to ask something in return: the publication of the names of the legal and beneficial owners of the company.

Some of the UK companies named in *Grave Secrecy* were registered at mail-forwarding offices, such as this one. (Credit: Global Witness)

We are no longer the only ones calling for more information to be made available on company ownership:

- **European financial institutions** have started calling for more information to be provided by governments on corporate ownership to help them carry out the customer due diligence that they are legally required to do.[28]

- The **European parliament** has backed calls for more corporate transparency in two resolutions.

  A resolution on ways to combat tax evasion states that "strengthening the regulation of, and transparency as regards, company registries and registers of trust is a prerequisite for dealing with tax avoidance".[29]

  A resolution on combating corruption calls on the Commission "to make the fight against the abuse of anonymous shell companies in secrecy jurisdictions, enabling criminal financial flows, a key element of the upcoming reform of the Anti-Money Laundering (AML) Directive."[30]

- The **World Bank** recommended that "In cases in which a director is acting as a nominee for another person, that fact should be noted in the registry, along with the name of the 'shadow director'."[31]

- The **Financial Action Task Force** in its new anti-money laundering recommendations stated that countries should consider requiring nominees to declare themselves as such and say on whose behalf they are working.[32]

- The 2010 **EU Internal Security Strategy** includes a suggestion that the EU's Anti-Money Laundering Directive should be used to 'enhance the transparency of legal persons and legal arrangements'.[33]

- ***The Economist,*** in a leader in January 2012, came out in favour of beneficial ownership transparency.[34]

Without a radical rethink of the design and enforcement of these key standards, countries such as Kyrgyzstan – let alone many other, much poorer countries in Africa and elsewhere – will struggle to develop while successive political and business leaders take advantage of lax systems of governance to plunder their nations' wealth.

All of the loopholes outlined in this report are also available, of course, to those who want to evade tax, traffic drugs and people and finance terrorism. Financial centres, both onshore and offshore, and the governments that are supposed to regulate them, remain complicit if they do not act.

"Anyone registering a limited company should have to declare the names of the real people who ultimately own it, wherever they are, and report any changes. Lying about this should be a crime."

The Economist, January 2012[35]

APPENDIX

Table 1. Results of the World Bank/UNODC study into compliance of company service providers with the FATF anti-money laundering recommendations[36]

	Compliant with money laundering standards	**Non-compliant with money laundering standards**
OECD countries		
United States	12	35
Other OECD countries	3	24
Non OECD countries		
Tax havens	34	2
Non tax havens	15	4

Table 2. FATF member states' level of compliance with FATF recommendation 33, on the requirement for countries to take measures to prevent the unlawful use of legal persons by money launderers, as assessed by the FATF Mutual Evaluations

Compliant	**Largely compliant**	**Partially compliant**	**Not compliant**
			Argentina
	Australia		
		Austria	
		Belgium [37]	
		Brazil	
			Canada
			China
		Denmark	
		Finland	
	France		
			Germany
			Greece
		Hong Kong, China	
		Iceland	
		India	
		Ireland	
Italy			
			Japan
			Korea
		Luxembourg	
			Mexico
		Netherlands	
		New Zealand	
	Norway		
		Portugal	
		Russia	
		Singapore	
			South Africa
		Spain	
		Sweden	
			Switzerland
		Turkey	
		United Kingdom	
			United States
Total = 1	**Total = 3**	**Total = 19**	**Total = 11**

Table 3. Whether various jurisdictions surveyed by the World Bank permit companies to use nominee directors[38]

Jurisdiction	Nominee directors permitted for companies?
Anguilla	Yes
Antigua and Barbuda	Yes
Belize	Yes
Bermuda	Yes
British Virgin Islands	Yes
Cayman Islands	Yes
Cook Islands	No
Cyprus	Yes
Czech Republic	Yes
Delaware, USA	Yes
Dubai, UAE	Yes
Florida, USA	Yes
Gibraltar	Yes
Guernsey	Yes
Hong Kong SAR, China	Yes
Isle of Man	Yes
Jersey	Yes
Liechtenstein	Yes
Luxembourg	Yes
Mauritius	Yes
Netherlands Antilles	Yes
Nevada, USA	Yes
Nevis	Yes
Ontario, Canada	Yes
Panama	Yes
Seychelles	Yes
Singapore	Yes
South Africa	Yes
St Kitts	Yes
St Lucia	-
St Vincent and the Grenadines	Yes
Switzerland	-
Turks and Caicos	Yes
United Kingdom	Yes
Uruguay	-
Wyoming, USA	Yes

REFERENCES

[1] Financial Action Task Force, *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation - the FATF Recommendations.* Feb 2012. http://www.fatf-gafi.org/topics/fatfrecommendations/documents/fatfrecommendations2012.html

[2] Stolen Asset Recovery Initiative, *Puppet Masters: how the corrupt use legal structures to hide stolen assets and what to do about it.* 2011. The Stolen Asset Recovery Initiative is a World Bank and UNODC initiative. *Puppet Masters* states that "In cases in which a director is acting as a nominee for another person, that fact should be noted in the registry, along with the name of the 'shadow director'."

[3] Financial Action Task Force, *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation - the FATF Recommendations.* Feb 2012. http://www.fatf-gafi.org/topics/fatfrecommendations/documents/fatfrecommendations2012.html

[4] OECD, *Behind the corporate veil: using corporate entities for illicit purposes.* 2001. http://www.oecd.org/document/19/0,3343,en_2649_34795_43731027_1_1_1_1,00.html

[5] United States Government Accountability Office, *Company Formations: minimal ownership information is collected and available.* Apr 2006. http://www.gao.gov/new.items/d06376.pdf. No states require ownership information of corporations at the time the corporation is formed. Only Alaska, Arizona and Maine require corporations to state ownership information in subsequent public annual or biennial reports, and Maine only requires this if there are no directors. Kansas used to have such a requirement but removed it in 2004. Most states require corporations maintain a list of shareholders but these are not part of the public record.

[6] OpenCorporates, *The closed world of company data: an examination of how open company data is in Open Government Partnership countries.* April 2012. http://opencorporates.com/downloads/ogp_company_data_report.pdf

[7] U4 Corruption Resource Centre, *Mutual legal assistance treaties and money laundering.* July 2008. www.u4.no/publications/mutual-legal-assistance-treaties-and-money-laundering

[8] Global Witness, *Goldman Sachs backs Angolan oil deal despite corruption risks.* 20 May 2012. http://www.globalwitness.org/library/goldman-sachs-backs-angolan-oil-deal-despite-corruption-risks

[9] Financial Times, *Angola officials held hidden oil stakes.* 16 April 2012 [behind a paywall]

[10] Financial Action Task Force, *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation - the FATF Recommendations.* Feb 2012. http://www.fatf-gafi.org/topics/fatfrecommendations/documents/fatfrecommendations2012.html

[11] Global Witness, *Secrecy surrounding Glencore's business deals in the Democratic Republic of Congo risks exposing shareholders to corrupt practices.* May 2012. http://www.globalwitness.org/library/glencore-%E2%80%98should-explain-potentially-corrupt-deals-congo%E2%80%99-%E2%80%93-global-witness

[12] Global Witness press release, *£10m house in expensive London suburb recovered by Libya.* March 2012. http://www.globalwitness.org/library/%C2%A310m-house-expensive-london-suburb-recovered-libya

[13] Stolen Asset Recovery Initiative, *Puppet Masters: how the corrupt use legal structures to hide stolen assets and what to do about it.* 2011. The Stolen Asset Recovery Initiative is a World Bank and UNODC initiative. http://www1.worldbank.org/finance/star_site/documents/Puppet%20Masters%20Report.pdf

[14] Global Witness, *Diamonds: A good deal for Zimbabwe?* February 2012. http://www.globalwitness.org/library/diamonds-good-deal-zimbabwe

[15] The description is Geoffrey's own description of his business taken from his website, according to the High Court of New Zealand Decisions, Lupton v Commissioner of Inland Revenue Department HC Wellington CIV 208-485-2460 [2011] NZHC, 15 March 2011.

[16] Stolen Asset Recovery Initiative, *Puppet Masters: how the corrupt use legal structures to hide stolen assets and what to do about it.* 2011. The Stolen Asset Recovery Initiative is a World Bank and UNODC initiative.

[17] Stolen Asset Recovery Initiative, *Puppet Masters: how the corrupt use legal structures to hide stolen assets and what to do about it.* 2011. The Stolen Asset Recovery Initiative is a World Bank and UNODC initiative. *Puppet Masters* states that "In cases in which a director is acting as a nominee for another person, that fact should be noted in the registry, along with the name of the 'shadow director'."

[18] Financial Action Task Force, *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation - the FATF Recommendations.* Feb 2012. http://www.fatf-gafi.org/topics/fatfrecommendations/documents/fatfrecommendations2012.html

[19] Financial Action Task Force, *40+9 Recommendations.* 2004. Recommendation 12. http://www.fatf-gafi.org/topics/fatfrecommendations/documents/40recommendations.html

[20] Recommendation 24 specifies that company service providers (and others) are subject to effective systems for monitoring and ensuring their compliance with requirements to combat money laundering and terrorist financing. Note that t he FATF Recommendations were updated in 2012. What was Recommendation 24 is now referred to as Recommendation 28, though the old numbering system has been used here as the data in the table

refers to assessments that were made using the 2004 Recommendations.

[21] Eurostat, *Money laundering in Europe: Report of work carried out by Eurostat and DG Home Affairs*. 2010. http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-RA-10-003/EN/KS-RA-10-003-EN.PDF

[22] Global Witness phone interview with HMRC representative, 31 August 2011

[23] Global Witness phone interview with HMRC representative, 31 August 2011

[24] Eastern and Southern Africa Anti-Money Laundering Group, *Mutual evaluation report: anti-money laundering and combating the financing of terrorism. The Republic of the Seychelles.* 2008. http://www.esaamlg.org/userfiles/Seychelles_Mutual_Evaluation_Report.pdf

[25] Computer Weekly, *UK Companies House register contains 3,994 high-risk individuals, Datanomic finds*. 21 Feb 2008. http://www.computerweekly.com/news/2240085116/UK-Companies-House-register-contains-3994-high-risk-individuals-Datanomic-finds

[26] Some small and medium sized companies can provide abbreviated accounts. http://www.companieshouse.gov.uk/about/pdf/gp2.pdf

[27] Tax Research UK, 500,000 missing people: £16 billion of lost tax: how the UK mismanages its Companies. March 2011. http://www.taxresearch.org.uk/Documents/500000Final.pdf

[28] In particular, the European Banking Industry Committee and the European Banking Federation, in a written responses to the Financial Action Task Force, stated that they were in favour of public registries

[29] European Parliament resolution on the call for concrete ways to combat tax fraud and tax evasion, 17 April 2012 (2012/2599(RSP))

[30] European Parliament resolution on the EU's efforts to combat corruption', 7 September 2011 (2011/2744(RSP))

[31] Stolen Asset Recovery Initiative, *Puppet Masters: how the corrupt use legal structures to hide stolen assets and what to do about it*. 2011. The Stolen Asset Recovery Initiative is a World Bank and UNODC initiative. http://www1.worldbank.org/finance/star_site/documents/Puppet%20Masters%20Report.pdf

[32] Financial Action Task Force, *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation - the FATF Recommendations.* Feb 2012. http://www.fatf-gafi.org/topics/fatfrecommendations/documents/fatfrecommendations2012.html

[33] European Commission, *The EU internal security strategy in Action: five steps towards a more secure Europe.* Nov 2010. http://ec.europa.eu/commission_2010-2014/malmstrom/archive/internal_security_strategy_in_action_en.pdf

[34] The Economist, *Light and wrong.* Jan 2012. http://www.economist.com/node/21543164

[35] The Economist, *Light and wrong.* Jan 2012. http://www.economist.com/node/21543164

[36] Stolen Asset Recovery Initiative, World Bank/UNODC, *Puppet Masters: how the corrupt use legal structures to hide stolen assets and what to do about it*. 2011. http://www1.worldbank.org/finance/star_site/documents/Puppet%20Masters%20Report.pdf

[37] Note that Belgium is subject to biennial updates to FATF to address deficiencies identified in its mutual evaluation. The most recent update notes various improvements in compliance with recommendation 33, though the report does not state whether these are sufficient to amount to a largely compliant or compliant rating.

[38] Stolen Asset Recovery Initiative, *Puppet Masters: how the corrupt use legal structures to hide stolen assets and what to do about it*. 2011. The Stolen Asset Recovery Initiative is a World Bank and UNODC initiative. http://www1.worldbank.org/finance/star_site/documents/Puppet%20Masters%20Report.pdf