

# Behind the Corporate Veil

USING CORPORATE ENTITIES  
FOR ILLICIT PURPOSES



OECD



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ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

# ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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- to contribute to sound economic expansion in Member as well as non-member countries in the process of economic development; and
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L'UTILISATION DES ENTITÉS JURIDIQUES A DES FINS ILLICITES

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## Foreword

Almost every economic crime involves the misuse of corporate entities – money launderers exploit cash-based businesses and other legal vehicles to disguise the source of their illicit gains, bribe-givers and recipients conduct their illicit transactions through bank accounts opened under the names of corporations and foundations, and individuals hide or shield their wealth from tax authorities and other creditors through trusts and partnerships, to name but a few examples.

In recent years, the issue of the misuse of corporate entities for illicit purposes has drawn increasing attention from policy makers and other authorities. While corporate entities have been credited for their immense contribution to rising prosperity in market-based economies, there has been growing concern that these vehicles may be misused for illicit purposes, such as money laundering, bribery and corruption, shielding assets from creditors, illicit tax practices, market fraud, and other illicit activities. Perhaps more worrisome is the risk that the misuse of corporate entities may threaten financial stability from a market integrity perspective.

In light of these concerns, the Financial Stability Forum (FSF) asked the OECD in May 2000 to undertake the drafting of a report to develop mechanisms to reduce the vulnerability of corporate vehicles to misuse for illicit purposes. In particular, the FSF stressed the importance of ensuring that the authorities in each jurisdiction have the ability to obtain and share information on the beneficial ownership and control of corporate vehicles established in their jurisdictions. This report responds to that request.

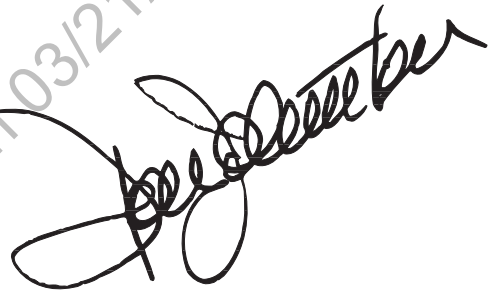
The OECD Steering Group on Corporate Governance assumed overall responsibility for the drafting of this report and established an *ad hoc* experts group to guide the OECD Secretariat in the drafting process. Upon its completion and adoption by the Steering Group, the “Report on the Misuse of Corporate Vehicles for Illicit Purposes” was submitted to the OECD Ministers, G-7 Finance Ministers, and FSF. At their annual meeting in May 2001, the OECD Ministers welcomed the report, adding that it will contribute to efforts to combat corruption and money laundering. As part of their continuing efforts to fight against the abuses of the

global financial system, the G-7 Finance Ministers in July 2001 also welcomed this report and noted its potential to contribute to efforts to fight money laundering.

Within the OECD, this report is being used in connection with our efforts to curb harmful tax practices and combat corruption. In addition, the report is expected to aid the Financial Action Task Force's review of its Forty Recommendations, including issues relating to the misuse of corporate entities for money laundering purposes. It is the hope of the OECD that other national and international fora engaged in similar endeavours, as well as policy makers and other authorities contemplating steps to prevent the misuse of corporate vehicles, also make use of this report in their work.

I would like to express my appreciation to the members of the *ad hoc* experts group and the OECD Secretariat staff who devoted long hours to drafting this report. Their hard work and dedication enabled the completion of this report under an ambitious and tight time schedule.

This report is published under the responsibility of the Secretary-General of the OECD.

A handwritten signature in black ink, appearing to read 'Donald J. Johnston', written in a cursive style. The signature is positioned above the printed name and title.

Donald J. Johnston  
Secretary-General

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## Executive Summary

Corporate vehicles are legal entities through which a wide variety of commercial activities are conducted and assets are held. They are the basis of most commercial and entrepreneurial activities in market-based economies and have contributed immensely to the prosperity and globalisation that have occurred over the last half century. Today, the rapid flows of private capital, ideas, technology, and goods and services involve corporate vehicles at virtually every level. While corporate vehicles play an essential role in the global economic system, these entities may, under certain conditions, be misused for illicit purposes, including money laundering, bribery/corruption, hiding and shielding assets from creditors, illicit tax practices, self-dealing/defrauding assets/diversion of assets, market fraud and circumvention of disclosure requirements, and other forms of illicit behaviour.

In May 2000, the Financial Stability Forum Working Group on Offshore Financial Centres made a request to the Organisation for Economic Co-operation and Development (OECD) to explore the issue of developing mechanisms to prevent the misuse of corporate vehicles by ensuring that supervisors and law enforcement authorities (the “authorities”) are able to obtain, on a timely basis, information on the beneficial ownership and control of corporate vehicles and to share that information with foreign authorities. Following this request, the OECD Steering Group on Corporate Governance agreed to undertake the drafting of a report on the Misuse of Corporate Vehicles for Illicit Purposes (the “Report”). At their annual meeting in June 2000, the OECD Ministers noted that the OECD would conduct analytical work on the misuse of corporate entities. At their July 2000 meeting in Japan, the G-7 Finance Ministers welcomed this forthcoming review.

This Report examines the misuse of a variety of “*corporate vehicles*”, including corporations, trusts, foundations, and partnerships with limited liability features. This Report does not address corporate vehicles that are engaged in financial services activities, or whose shares are publicly traded or listed on a stock exchange.

While the Report examines both onshore and offshore jurisdictions, it places a greater focus on offshore financial centres (OFCs) for three reasons. First, some offshore jurisdictions provide excessive secrecy for their corporate vehicles and



create a favourable environment for their misuse for illicit purposes. Second, shell companies constitute a substantial proportion of the corporate vehicles established in some OFCs. Given their function, shell companies face an increased risk of being misused for illicit purposes. Third, a number of other offshore jurisdictions have developed specialised, sophisticated, and robust regimes for obtaining and sharing information on beneficial ownership and control and/or are undertaking serious efforts to strengthen their regulatory, supervisory, and legal regimes in order to curtail the misuse of corporate vehicles for illicit purposes. The regimes maintained in the latter groups of OFCs may serve as useful models for other jurisdictions seeking to improve the functioning and transparency of their regulatory, supervisory, and legal systems and/or to strengthen the mechanisms for obtaining and sharing information on beneficial ownership and control.

In essence, any jurisdiction that provides mechanisms enabling individuals to successfully hide their identity behind a corporate vehicle while excessively constraining the capacity of authorities to obtain and share information on beneficial ownership and control for regulatory/supervisory and law enforcement purposes is increasing the vulnerability of its corporate vehicles to misuse. Certain jurisdictions allow corporate vehicles established in their jurisdictions to use instruments that obscure beneficial ownership and control, such as bearer shares, nominee shareholders, nominee directors, “corporate” directors, flee clauses, and letters of wishes, without devising effective mechanisms that would enable the authorities to identify the true owners and controllers when illicit activity is suspected or to fulfil their regulatory/supervisory responsibilities. Some of these jurisdictions further protect anonymity by enacting strict bank and corporate secrecy laws that prohibit company registrars, financial institutions, lawyers, accountants, and others, under the threat of civil and criminal sanctions, from disclosing any information regarding beneficial ownership and control to regulatory/supervisory and law enforcement authorities. These jurisdictions should carefully consider whether the benefits of such practices outweigh the costs or whether they should be permitted, if at all, only under special conditions and in limited circumstances.

In order to successfully combat and prevent the misuse of corporate vehicles for illicit purposes, it is essential that all jurisdictions establish effective mechanisms that enable their authorities to obtain, on a timely basis, information on the beneficial ownership and control of corporate vehicles established in their own jurisdictions for the purpose of investigating illicit activities, fulfilling their regulatory/supervisory functions, and sharing such information with other authorities domestically and internationally. This requires adherence to three fundamental objectives (“Fundamental Objectives”), namely that 1) beneficial ownership and control information must be maintained or be obtainable by the authorities, 2) there must be proper oversight and high integrity of any system for maintaining or obtaining beneficial ownership and control information, and 3) non-public infor-

mation on beneficial ownership and control must be able to be shared with other regulators/supervisors and law enforcement authorities, both domestically and internationally, for the purpose of investigating illicit activities and fulfilling their regulatory/supervisory functions respecting each jurisdiction's own fundamental legal principles. In addition, it is desirable that policymakers in each jurisdiction consider ways to make it possible to grant access to beneficial ownership and control information to agents with authority delegated by the government or the judiciary (such as insolvency administrators) and financial institutions seeking beneficial ownership and control information in order to comply with their customer identification and due diligence ("customer identification") requirements under anti-money laundering laws.

The mechanisms for obtaining beneficial ownership and control information fall into three broad categories – 1) primary reliance on an up front disclosure to the authorities, 2) primary reliance on intermediaries (such as company formation agents, trust companies, registered agents, lawyers, notaries, trustees, and companies supplying nominee shareholders, directors and officers) involved in the formation and management of corporate vehicles ("corporate service providers") to maintain beneficial ownership and control information ("Intermediary Option"), and 3) primary reliance on an investigative system. Provided that there is full adherence to the Fundamental Objectives discussed above, each jurisdiction may tailor and/or combine these three options to fit local conditions, legal systems, and practices.

Opting for an up front disclosure system means that extensive disclosure of beneficial ownership and control information to the authorities will be required at the establishment stage and that an obligation to update such information when changes occur will be imposed. Under an Intermediary Option, corporate service providers are required to obtain, verify, and retain records on the beneficial ownership and control of the corporate vehicles that they establish, administer, or for which they provide fiduciary services and to grant authorities access to such records for the purpose of investigating illicit activities and fulfilling their regulatory/supervisory functions. Primary reliance on an investigative system means that the authorities rely primarily on compulsion power, court-issued subpoenas, and other measures to penetrate the legal entity in order to identify the beneficial owners when illicit activity is suspected. Under all options, it is essential that the authorities in each jurisdiction have the capacity to share information on the beneficial ownership and control of corporate vehicles with other authorities domestically and internationally respecting each jurisdiction's own fundamental legal principles.

While a number of possible options are available for obtaining beneficial ownership and control information, not all options are suitable for all jurisdictions. Primary reliance on an up front disclosure system would be appropriate in juris-

dictions with 1) a generally weak investigative system; 2) high proportion of non-resident ownership of corporate vehicles (particularly those owned by individuals or by shell corporations); 3) high proportion of shell companies or asset holding companies and; 4) anonymity-enhancing instruments. Primary reliance on an Intermediary Option would be appropriate in jurisdictions with 1) adequate investigative mechanisms to effectively monitor compliance by corporate service providers with their obligation to obtain beneficial ownership and control information and 2) a sufficient number of corporate service providers with suitable experience and adequate resources to undertake the collection and maintenance of beneficial ownership and control information. Lastly, primary reliance on an investigative mechanism would be appropriate in jurisdictions where 1) the authorities possess strong compulsory powers and capacity to obtain beneficial ownership and control information; 2) there is a reliable history of enforcement; 3) the judicial system functions effectively and efficiently; and 4) beneficial ownership and control information is likely to be available within the jurisdiction.

As the options for obtaining beneficial ownership and control information are, to a large degree, complementary, jurisdictions that rely primarily on one particular option may, depending on their particular circumstances, find it highly desirable and beneficial to supplement this mechanism with other options.

With respect to information sharing, the 1998 G-7 Ten Key Principles on Information Sharing and the 1999 G-7 Ten Key Principles for the Improvement of International Cooperation Regarding Financial Crime and Regulatory Abuse (together, the “G-7 Principles”) are important in the context of domestic and international rules, practices, and mechanisms governing international co-operation. The G-7 Principles address the most significant issues relating to sharing information on beneficial ownership and control of corporate vehicles among regulators/supervisors and law enforcement authorities.

# Introduction

## A. Background

In recent years, a number of international fora have sought to examine the extent to which the misuse of corporate vehicles for illicit purposes impacts the global financial system. In April 2000, the Financial Stability Forum (FSF) Working Group on Offshore Financial Centres concluded that the misuse of corporate vehicles could threaten financial stability from a market integrity perspective. Over the past decade, the Financial Action Task Force on Money Laundering (FATF) has noted the role of corporate vehicles in money laundering schemes. Similarly, the Organisation for Economic co-operation and Development (OECD) Working Group on Bribery in International Business Transactions has found that the misuse of corporate vehicles in offshore financial centres<sup>1</sup> (OFCs) can hinder otherwise successful anti-corruption investigations. Through its work on corporate governance, the OECD became aware that corporate vehicles can be misused to perpetrate improper self-dealing, circumvent regulations, and manipulate equity markets. Other international organisations and institutions, including the United Nations (UN) and the European Commission (EC), have also observed the recurring misuse of all forms of corporate vehicles in organised criminal activity, particularly financial and economic crimes. Because of the potential for abuse of today's open and global financial system, which could result in the misallocation of resources and increase systemic risk, the issue of the misuse of corporate vehicles for illicit purposes has come to the forefront of policy makers' agendas.

In its April 2000 report,<sup>2</sup> the FSF Working Group on Offshore Financial Centres recommended, among other things, that an appropriate international forum be asked to explore the issue of developing mechanisms to prevent the misuse of corporate vehicles by ensuring that supervisors and law enforcement authorities (the "authorities") are able to obtain, on a timely basis, information on the beneficial ownership and control of corporate vehicles and to share that information with foreign authorities. Following a request by the FSF to the OECD to develop mechanisms to prevent the misuse of corporate vehicles, the OECD Steering Group on Corporate Governance agreed to undertake the drafting of a report on the Misuse of Corporate Vehicles for Illicit Purposes (the "Report"). At their annual meeting in

June 2000, the OECD Ministers noted that the OECD would conduct analytical work on the misuse of corporate entities. At their July 2000 meeting in Japan, the G-7 Finance Ministers welcomed this forthcoming review.

The overall goal of the Report is to contribute to the current and future work of international and national fora in curbing the misuse of corporate vehicles for illicit purposes. Recently, there has been considerable interest in examining mechanisms for obtaining and sharing information on the beneficial ownership and control of corporate vehicles for regulatory/supervisory and law enforcement purposes. The FATF is undertaking a review of its Forty Recommendations, including those concerning the identification of beneficial ownership and control of corporate vehicles. The OECD Committee on Fiscal Affairs is developing an application note on the need for beneficial ownership information to enhance transparency and effective exchange of information in connection with its effort to curb harmful tax practices. At their October 2000 ECOFIN meeting, the European Union Ministers called for further work on developing mechanisms to identify the beneficial owners of legal entities. In addition, Recommendation No. 8 of the Action Plan to Combat Organised Crime, adopted by the Council of the European Union (EU) on 28 April 1997, called on Member States to collect information with respect to the physical persons involved in the creation, direction, and funding of legal persons registered in their countries.<sup>3</sup>

According to the Terms of Reference adopted by the OECD Steering Group on Corporate Governance, the objectives of the Report are:

1. To form an understanding of how corporate vehicles can be misused for illicit purposes;
2. To identify and analyse the factors limiting the capacity of supervisors and law enforcement authorities (the “authorities”) to obtain, on a timely basis, information about the beneficial ownership and control of corporate vehicles and their ability to share this information with authorities domestically and internationally; and
3. To develop a menu of possible options that countries can adopt to obtain and share such information.

This Report will examine the misuse of a variety of “*corporate vehicles*”, including corporations, trusts, foundations, and partnerships with limited liability features. This Report will not cover corporate vehicles engaged in financial services, such as banking, insurance, mutual funds, and other related activities, even though these activities may be conducted through a corporate vehicle. In addition, this Report will exclude publicly traded/listed companies.<sup>4</sup> Compared to their non-financial services and non-listed counterparts, financial services and listed corporate vehicles are generally subject to more rigorous regulation and supervision, including periodic disclosure of information concerning directors and major shareholders

(including beneficial owners). In addition, many of their activities are addressed by international principles and standards, such as the Basle Core Principles for Effective Banking Supervision, the International Association of Insurance Supervisors Insurance Principles and Standards, the International Organization of Securities Commissions (IOSCO) Objectives and Principles of Securities Regulation, and the OECD Principles of Corporate Governance. In contrast, non-financial services and non-publicly traded corporate vehicles may be more vulnerable to misuse for illicit purposes because these entities are subject generally to less stringent regulation and supervision and there are no international principles or standards on their formation and management.

## **B. Corporate Vehicles and Their Potential for Misuse for Illicit Purposes**

Corporate vehicles are legal entities through which a wide variety of commercial activities are conducted and assets are held. They are the basis of most commercial and entrepreneurial activities in market-based economies. Corporate vehicles have become an integral and indispensable part of the modern global financial landscape and have contributed immensely to the prosperity and globalisation that have occurred over the last half century. Today, the rapid flows of private capital, ideas, technology, and goods and services involve corporate vehicles at virtually every level.

Despite the important and legitimate roles that corporate vehicles play in the global economic system, these entities may, under certain conditions, be misused for illicit purposes, including money laundering, bribery/corruption, improper insider dealings, illicit tax practices, and other forms of illicit behaviour.<sup>5</sup> Using corporate vehicles as conduits to perpetrate illicit activities is potentially appealing because these vehicles may enable the perpetrators to cloak their malfeasance behind the veil of a separate legal entity. A recent report commissioned by the EC concluded that the ability of legal entities to effectively conceal the identity of their beneficial owners stimulates their use for criminal activities.<sup>6</sup> Even in jurisdictions with bank secrecy laws, perpetrators of illicit activities prefer to deposit their ill-gotten gains in an account opened under the name of a corporate vehicle because bank secrecy protections may be lifted in certain situations.

Any jurisdiction that provides mechanisms enabling individuals to successfully hide their identity behind a corporate vehicle while excessively constraining the capacity of authorities to obtain and share information on beneficial ownership and control for regulatory/supervisory and law enforcement purposes is increasing the vulnerability of its corporate vehicles to misuse. Certain jurisdictions, for example, allow corporate vehicles incorporated or established in their jurisdictions to employ instruments that can be used to obscure beneficial ownership and control, such as bearer shares, nominee shareholders, and nominee

directors, without devising effective mechanisms that would enable the authorities to identify the true owners and controllers when illicit activity is suspected or to fulfil their regulatory/supervisory responsibilities. Some of these jurisdictions further protect anonymity by enacting strict secrecy laws that prohibit company registrars, financial institutions, lawyers, accountants, and others, under the threat of civil and criminal sanctions, from disclosing any information regarding beneficial ownership and control to regulatory/supervisory and law enforcement authorities.

### C. Ability to Obtain and Share Information on Beneficial Ownership and Control

In order to effectively combat and prevent the misuse of corporate vehicles for illicit purposes, it is essential that the authorities have the capacity to obtain, on a timely basis, information on the beneficial ownership and control of corporate vehicles. In this Report, “*beneficial ownership*” refers to ultimate beneficial ownership or interest by a natural person. In some situations, uncovering the beneficial owner may involve piercing through various intermediary entities and/or individuals until the true owner who is a natural person is found. With respect to corporations, ownership is held by shareholders or members. In partnerships, interests are held by general and limited partners. In trusts and foundations, beneficial ownership refers to beneficiaries, which may also include the settlor or founder. In this Report, “*control*” means effective control by an individual or a group of individuals over a corporate vehicle. Thus, with respect to the types of corporate vehicles examined in this Report, the relevant inquiry will be who exercises effective control (rather than legal control) over the corporate vehicle. In many misuses of corporate vehicles, the beneficial owner or settlor/founder controls the corporate vehicle despite outward appearances suggesting control by a third party. For example, directors of a corporation could merely be “nominees” who pass on the duties required of a director to the beneficial owner and accept instructions from the beneficial owner. With respect to trusts, the settlor may continue to exercise effective control over the trustee through the use of a trust “protector” and a letter of wishes [see *Trusts* (Part I.B.2) for a more detailed discussion of these instruments].

Jurisdictions employ a variety of mechanisms to obtain information on beneficial ownership and control. Most jurisdictions rely on compulsion power, court-issued subpoenas, and other measures to penetrate the legal entity in order to identify the beneficial owners when illicit activity is suspected.<sup>7</sup> In a small number of jurisdictions, the authorities require extensive disclosure of beneficial ownership and control information to the authorities at the formation stage and some impose an obligation to update such information when changes occur. An increasing number of jurisdictions are supplementing these approaches by requiring intermediaries.<sup>8</sup> involved in the formation and management of corporate vehicles (“corporate service providers”) to obtain, verify, and retain records on beneficial ownership and control and to grant authorities access to such records for the

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<sup>14</sup>

purpose of investigating illicit activities, fulfilling their regulatory/supervisory functions, and sharing such information with other authorities domestically and internationally.

The ability of authorities to obtain information on beneficial ownership and control must also be accompanied by a corresponding capacity to share that information with other authorities domestically and internationally respecting each jurisdiction's own fundamental legal principles. The ability to share information among domestic authorities, such as securities regulators, law enforcement agencies, banking regulators, and tax authorities, is important because certain authorities in a jurisdiction may possess, or have better access to, beneficial ownership and control information that is required by other domestic authorities for regulatory/supervisory or law enforcement purposes. In addition, it is desirable that the authorities consider ways to make it possible to grant access to beneficial ownership and control information to agents with authority delegated by the government or the judiciary (such as insolvency administrators) and financial institutions seeking such information in order to comply with customer identification and due diligence ("customer identification") requirements under anti-money laundering laws. The availability of mechanisms to share information domestically also facilitates the efficient use of scarce resources by ensuring that duplicate efforts to obtain beneficial ownership and control information are not undertaken.

Given that anonymity is often enhanced through the use of corporate vehicles incorporated in foreign jurisdictions, it is equally critical that the authorities also have the ability to share information on beneficial ownership and control internationally. Recognising that there are often impediments to effective and efficient exchange of information between jurisdictions, perpetrators often use groups of corporate vehicles, each established in a different high-secrecy jurisdiction, to frustrate any effort by the authorities to identify the beneficial owner.

Recently, a number of EU member States have reported that foreign established corporate vehicles, including those established in OFCs, have been increasingly misused for criminal purposes.<sup>9</sup> The G-8 Justice and Interior Ministers also noted that the reluctance or refusal of certain jurisdictions to assist foreign authorities in obtaining information has enabled perpetrators to misuse the corporate entities established in those jurisdictions.<sup>10</sup> It is important to stress that authorities in all jurisdictions must be empowered to obtain and share such information on a timely basis as delays will give the perpetrators of crime time to erect an additional layer of anonymity in yet another jurisdiction.<sup>11</sup> Information on beneficial ownership and control may be shared through a number of mechanisms, ranging from formal mechanisms, such as mutual legal assistance treaties (MLATs) and memoranda of understanding (MOUs), to less formal arrangements and *ad hoc* assistance.



## D. Methodology

The OECD Steering Group on Corporate Governance assumed overall responsibility for the drafting of this Report and established an *ad hoc* experts group ("Experts Group") to guide the OECD Secretariat in the drafting process. All Member countries were invited to nominate experts to the Experts Group. Upon its constitution, the Experts Group comprised experts from 12 Member countries. In addition, the OECD Working Group on Bribery in International Business Transactions co-operated in the preparation of this Report. The OECD Secretariat also conducted field visits to selected jurisdictions to discuss with government officials and private sector practitioners how issues relating to the misuse of corporate vehicles for illicit purposes are addressed in those jurisdictions. In addition, the OECD Secretariat conducted telephone interviews or arranged meetings in Paris with a number of government officials from OECD Member countries to discuss these issues.

Lastly, the Report drew upon existing analytical work on the misuse of corporate vehicles and the mechanisms and principles on obtaining and sharing information on beneficial ownership and control, including work conducted by the EC, FATF, FSF, G-7 Finance Ministers, IOSCO, OECD, and the United Nations as well as reports drafted by, or under the direction of, national governments.

Parts I and II of the Report are not intended to be comprehensive or exhaustive. These two sections are intended to be analytical in nature. The primary objective of Part I is to increase awareness regarding the various misuses of corporate vehicles for illicit purposes. The primary objective of Part II is to describe and analyse the main mechanisms utilised by authorities to obtain and share information on beneficial ownership and control. Given the analytical nature of this Report and the tight timeframe for its completion, the OECD Secretariat did not conduct, and did not consider it necessary to conduct, a comprehensive country-by-country survey. It did, however, attempt to examine a broad cross-section of jurisdictions, including onshore and offshore jurisdictions, large and small jurisdictions, and civil law and common law jurisdictions. Taking into account that only a selected number of countries were examined for this Report, it is important to note that the use of particular examples in this Report to illustrate problems faced by certain jurisdictions does not imply that such problems are confined only to these jurisdictions and that other jurisdictions do not face similar problems. At the same time, a problem faced in a certain jurisdiction may not be a problem in another jurisdiction because, among other things, the latter jurisdiction may have a more efficient corporate regulatory framework or stronger supervisory and information sharing powers. Lastly, Part III of the Report provides policymakers with a menu of options for obtaining and sharing beneficial ownership and control information among authorities domestically and internationally.

While the Report examines both onshore and offshore jurisdictions, it places a greater focus on offshore jurisdictions for three reasons. First, due to a combination of strict secrecy laws that do not permit confidential information to be passed on to domestic and international authorities in appropriate circumstances, weak company formation regulations, exemptions from periodic reporting requirements, and weak regulatory/supervisory and legal regimes, some offshore jurisdictions provide excessive secrecy for their corporate vehicles and create a favourable environment for their misuse for illicit purposes. Second, shell companies, which are entities established not to pursue any legitimate business activity but solely to obscure the identity of their beneficial owners and controllers, constitute a substantial proportion of the corporate vehicles established in some OFCs. Given their function, shell companies face an increased risk of being misused for illicit purposes. Third, a number of other offshore jurisdictions have developed specialised, sophisticated, and robust regimes for obtaining and sharing information on the beneficial ownership and control of corporate vehicles established in their jurisdictions.<sup>12</sup> Furthermore, some offshore jurisdictions are undertaking serious efforts to strengthen their regulatory, supervisory, and legal regimes in order to curtail the misuse of corporate vehicles for illicit purposes. Consequently, the regimes maintained in the latter groups of OFCs may serve as useful models for other jurisdictions seeking to improve the functioning and transparency of their regulatory, supervisory, and legal systems and/or to strengthen the mechanisms for obtaining and sharing information on beneficial ownership and control.

## **E. Structure of the Report**

Part I will examine the extent and means of misuse of corporate vehicles for illicit purposes. It will begin by discussing the types of corporate vehicles that are being misused for illicit purposes. Thereafter, Part I will examine the means through which anonymity is achieved and to what ends corporate vehicles have been misused. Part II will first examine the issues impacting the ability of authorities to obtain and share information on beneficial ownership and control. Subsequently, Part II will survey existing mechanisms that have been adopted by various jurisdictions to obtain and share information on beneficial ownership and control. Part III will present a menu of possible options to facilitate the capacity of authorities to obtain and share information on beneficial ownership and control with other authorities domestically and internationally. Annex I contains case studies illustrating the types of illicit activities that can be perpetrated through the misuse of corporate vehicles. Annex II contains the 1998 G-7 *Ten Key Principles on Information Sharing* and the 1999 G-7 *Ten Key Principles for the Improvement of International Cooperation Regarding Financial Crime and Regulatory Abuse* (together, the “G-7 Principles”).

## Notes

1. In its April 2000 report, the FSF Working Group on Offshore Financial Centres provided the following description of OFCs:  
*"Offshore financial centres (OFCs) are not easily defined, but they can be characterised as jurisdictions that attract a high level of non-resident activity. Traditionally, the term has implied some or all of the following (but not all OFCs operate this way) – 1) low or no taxes on business or investment income; 2) no withholding taxes; 3) light and flexible incorporation and licensing regime; 4) light and flexible supervisory regime; 5) flexible use of trusts and other special corporate vehicles; 6) no need for financial institutions and/or corporate structures to have a physical presence; 7) an inappropriately high level of client confidentiality based on impenetrable secrecy laws; and 8) unavailability of similar incentives to residents."*
2. Financial Stability Forum, *Report of the Working Group on Offshore Financial Centres*, 5 April 2000 ("FSF OFC Report").
3. See also Technical Committee of the IOSCO, *Report on the Issues Raised for Securities and Futures Regulators by Under-Regulated and Uncooperative Jurisdictions*, October 1994 (discussing problems in obtaining access to information located in jurisdictions that allow legal entities to be established without sufficient requirements that ownership information be recorded and maintained and where local laws, including secrecy laws, do not permit the information to be provided to foreign regulators).
4. In many countries, corporations are divided into private limited companies and public limited companies, with the latter being able to offer their shares to the public at large and list their shares on a stock exchange. This Report will examine misuses of private limited companies and public limited companies whose shares are not traded on a stock exchange.
5. In this Report, conduct is "illicit" if it is illegal in the perpetrator's country of citizenship, domicile, or residence.
6. T.M.C. Asser Institut, *Prevention of organised crime: The registration of legal persons and their directors and the international exchange of information* [commissioned by the European Commission ("Falcone programme")], 1 March 2000, p. 11 ("2000 EC Legal Persons Report").
7. While many jurisdictions require the submission of shareholders lists and director information to the authorities, they do not require a declaration of beneficial ownership where this differs from nominal ownership and do not require shareholders that are corporate vehicles to disclose their beneficial ownership.
8. These intermediaries include company formation agents, trust companies, registered agents, lawyers, notaries, trustees, and companies supplying nominee shareholders, directors and officers.
9. 2000 EC Legal Persons Report, pp. 116-117.

10. G-8 Communiqué, Moscow, 1999.
11. In its April 2000 report, the FSF Working Group on Offshore Financial Centres expressed its concern that “the lack of availability of timely information on beneficial ownership of corporate vehicles established in some offshore financial centres can thwart efforts directed at illegal business activity”. The 1998-1999 Financial Action Task Force *Money Laundering Typologies* report also noted that problems in obtaining information from certain jurisdictions on the beneficial owners of shell companies, international business corporations (IBCs), and offshore trusts were the primary obstacles in investigating transnational laundering activities (p. 19).
12. The Fourth European Conference of Specialized Services in the Fight Against Corruption, which was held in Cyprus on 20-22 October 1999, commented that “whereas some offshore jurisdictions offer bank secrecy, confidentiality, anonymity, tax avoidance facilities and fail to provide international co-operation in criminal matters, others have introduced measures of supervision and control that easily match, or on occasion may even exceed, those that can be found in some onshore jurisdictions”.

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## Part I

# The Extent and Means of Misuse of Corporate Vehicles for Illicit Purposes

### A. The Extent of Misuse of Corporate Vehicles for Illicit Purposes

It is extremely difficult to quantify with any precision the extent of misuse of corporate vehicles for illicit purposes. Nonetheless, a number of reports and surveys have concluded that corporate vehicles are used extensively in criminal activities. For example, a recent survey conducted of EU member States indicated that almost every criminal act, including economic crimes, involves the use of legal persons,<sup>1</sup> and the Euroshore Report asserted that corporations throughout the world are used to launder money.<sup>2</sup> Tax authorities in OECD Member countries have also expressed concern that individuals using corporate entities to hide their assets and activities in order to escape taxes legally due will likely grow.<sup>3</sup> In addition, the United Nations has noted that “the principal forms of abuse of secrecy have shifted from individual bank accounts to corporate bank accounts and then to trust and other corporate forms that can be purchased readily without even the modest initial and ongoing due diligence that is exercised in the banking sector”.<sup>4</sup> According to the FATF, shell companies are frequently used to facilitate bribery.<sup>5</sup> One estimate of bribes paid by Western companies to obtain influence and contracts puts the figure at US\$80 billion a year.<sup>6</sup> In the area of money laundering, the International Monetary Fund (IMF) has estimated that the amount of money laundered worldwide is between two to five per cent of the world gross domestic product, or about US\$600 billion to US\$1.5 trillion (using 1996 statistics) on an annual basis.

### B. Types of Corporate Vehicles Misused

As discussed above, a critical factor in misusing corporate vehicles is the potential for anonymity. Not surprisingly, therefore, the types of corporate vehicles that are misused most frequently are those that provide the greatest degree of anonymity, such as international business corporations (IBCs), exempt companies, trusts, and foundations established in jurisdictions that offer a high degree of secrecy and which do not maintain effective mechanisms that would enable their

authorities to identify the true owners when illicit activity is suspected. The use of these vehicles can also frustrate financial institutions' efforts to comply with customer identification requirements under anti-money laundering laws.

Corporate vehicles, such as corporations, trusts, foundations, and partnerships, are often used together to maximise anonymity. In addition, perpetrators of illicit activities frequently employ various corporate vehicles, each established in a different jurisdiction, in order to frustrate any effort by the authorities to discover the ultimate beneficial owner and controller (see *Alan Bond* case study).

This section will examine the types of corporate vehicles that are most vulnerable to misuse for illicit purposes. These include corporations, trusts, foundations, and partnerships with limited liability features.

### 1. *Corporations*

The corporation is the primary legal entity through which business activity is carried out in most market-based economies, and corporations account for a large percentage of investment and employment in most OECD Member countries. Corporations maintain a separate legal personality from their shareholders. Control of a corporation is vested in the board of directors<sup>7</sup> and shareholders have limited power to directly manage the corporation.<sup>8</sup> A corporation typically enjoys unlimited duration and free transferability of shares.<sup>9</sup> Ordinarily, the shareholders of a corporation are granted limited liability protection, which means that they can only lose the full amount of their investment and their personal assets will not be reachable by the corporation's creditors and other claimants. The limited liability feature of the corporation has been widely recognised as key in encouraging entrepreneurship and facilitating capital formation from a broad base of investors. On the other hand, due in part to its separate legal personality and its ability to obscure the identity of its true owners, the corporation can be misused to facilitate criminal conduct and other transgressions of the law.

The following summarises the types of corporations that are vulnerable to misuse for illicit purposes:

- a) *Private limited companies and public limited companies whose shares are not traded on a stock exchange*

In most jurisdictions, corporations are divided into public limited companies<sup>10</sup> (joint stock or share companies) and private limited companies<sup>11</sup> (companies limited by shares or guarantee). The primary distinctions between private and public limited companies are that the shares of a public limited company are freely transferable and there are no limits on the number of shareholders in a public limited company. These two features generally enable a public limited company to issue registered or bearer shares, offer its shares to the public at large, and trade its

shares on a stock exchange. In exchange for such flexibility, public limited companies submit themselves to rigorous regulation and supervision, such as frequent and detailed financial and non-financial disclosure and enhanced accountability at the board level. In contrast, private limited companies may only issue registered shares,<sup>12</sup> must restrict transfers of its shares, must limit the number of shareholders, and may not issue shares to the public at large. These restrictions also mean that private limited companies are not able to trade their shares on a stock exchange. In turn, private limited companies face a less stringent regulatory and supervisory regime than public limited companies. In most jurisdictions, the majority of corporations are private limited companies.

In the European Union (EU), private limited companies have been misused most frequently in part because of their lower minimum share capital requirements (*vis-à-vis* public limited companies) and because the identity of the shareholders of these entities are of “secondary relevance”.<sup>13</sup> A study conducted by the Performance and Innovation Unit of the UK Cabinet Office noted that U.K. shell companies have been involved in almost all complex UK money laundering schemes.<sup>14</sup> Recently, the US Financial Crimes Enforcement Network (FinCEN) identified an emerging trend of non-publicly traded, US-incorporated shell companies involved in suspicious wire transfer activities.<sup>15</sup> Hong Kong private limited companies have also proved to be attractive for money launderers because these entities are able to use nominee shareholders and corporations as directors and officers and are available off-the-shelf.<sup>16</sup>

In addition, limited liability companies (LLCs), a variant of the civil law private limited company, have been introduced recently in the United States and some common law OFCs. While the majority of LLCs may be engaged in legitimate business, they may also be vulnerable to misuse because they can be managed anonymously as there is no public disclosure of the members' identities.<sup>17</sup> Due to the availability of “charging order” protection (see *Limited partnerships and limited liability partnerships* (Part I.B.4) for a discussion of this concept), the LLC has also been touted as a vehicle that can be used to defeat, or at least delay, claims of creditors and other claimants. Lastly, public limited companies whose shares are not traded on a stock exchange are also vulnerable to misuse for illicit purposes because, in many jurisdictions, they are permitted to issue bearer shares without being subject to the more stringent regulatory requirements imposed on publicly traded companies.

*b) International business corporations/exempt companies*

International business corporations (IBCs) and exempt companies are the primary corporate forms employed in OFCs by non-residents. Licensing fees from IBCs and exempt companies provide an important source of revenues for many jurisdictions offering these vehicles. According to the FSF OFC Report, IBCs are

limited liability entities incorporated in an OFC and may be used to own and operate businesses, issue shares or bonds, or raise capital in other ways. In some OFCs, IBCs may be established instantly and for as little as US\$100 and they are generally exempt from all local taxes on profits, capital gains, and other income as well as stamp, gift and other taxes. IBCs are often barred from doing business in the jurisdiction in which they were incorporated and with that jurisdiction's residents. In addition, they often are not allowed to offer their shares to the public. In the family of corporations, IBCs generally fall into the category of private limited companies. Exempt companies have many of the same features as IBCs.

IBCs are used for many legitimate commercial activities, including holding intellectual property, engaging in international trading activities, legally obtaining the benefits of tax treaties, and serving as a holding company. In most jurisdictions, IBCs are not permitted to engage in banking, insurance, and other financial services.

The vulnerability of IBCs to misuse for illicit purposes depends to a considerable extent on their "anonymity" features and the type of regulatory regime to which they are subject. In many OFCs, IBCs may issue bearer shares and may employ nominee shareholders and nominee directors to disguise ownership and control. IBCs are often subjected to little or no formal supervision, with no requirement to file annual returns or annual accounts. In contrast, some OFCs prohibit the use of bearer shares, or, if bearer shares are permitted, require the disclosure of beneficial ownership and control information to the authorities. In a few jurisdictions, the authorities also undertake a rigorous vetting process of the applicants (including beneficial owners) for IBCs. Nonetheless, given the fact that IBCs are not allowed to conduct any business activity within the jurisdiction of incorporation or with that jurisdiction's residents, the authorities in jurisdictions offering these vehicles may have less incentive to undertake rigorous monitoring. Such misalignment of interest may make these vehicles more prone to misuse for illicit purposes, including use as shell companies to obscure the identity of the beneficial owners.

Even within OFCs, it is apparent why IBCs and exempt companies are more prone to misuse for illicit purposes. In many OFCs, there are separate regimes for resident and non-resident corporations. In some of these jurisdictions, resident companies are not allowed to use bearer shares and are subjected to greater regulatory scrutiny, including the requirement to file an annual return attaching a list of shareholders and information on directors and officers. In contrast, IBCs and/or exempt companies may issue bearer shares and are not required to file an annual return or disclose beneficial ownership. In summary, the combination of effective anonymity and little or no supervision make IBCs and exempt companies more susceptible to misuse.



## 2. Trusts<sup>18</sup>

A trust is an important, useful, and legitimate vehicle for the transfer and management of assets. Trusts provide an effective mechanism for managing assets given to minors, individuals who are incapacitated, and others who are otherwise inexperienced in financial management. Trusts can also be used to promote charitable purposes and for estate planning. In addition to personal and financial planning, trusts are increasingly used to structure corporate transactions, such as securitisation programs, and employee benefits programs, such as pension schemes, international employee stock option plans, and compensation structures.

The concept of “trust” originated from the English common law and today, trusts are used primarily in common law jurisdictions. The trust is a vehicle that provides for the separation of legal ownership from beneficial ownership. To establish a trust, the trust creator (the “settlor”) transfers the legal ownership of a property to a person or corporate entity (the “trustee”). The trustee holds and manages the property, in accordance with the provisions of a trust deed, for the benefit of the beneficiaries, who are identified in, or ascertainable from, the trust deed.<sup>19</sup> To create a valid trust, the settlor is required to give up control of the assets he has transferred to the trustee.<sup>20</sup> In turn, the trustee is obligated to observe the terms of the trust deed and has a fiduciary duty to act honestly and in good faith in the best interest of the beneficiaries or, in the event there are no named beneficiaries, in the best interest of the trust. Traditionally, trusts are subject to limitations on duration, the terms of the trust are fixed, and trustees cannot be removed without a legal challenge. Lastly, the traditional trust could only benefit individuals or charities and could not be used to delay, hinder, or defraud creditors (Statute of Elizabeth).

As with other types of corporate vehicles, however, trusts can also be misused for illicit purposes. Part of the attractiveness of misusing trusts lies in the fact that trusts enjoy a greater degree of privacy and autonomy than other corporate vehicles. Given the private nature of trusts and the fact that a trust is essentially a contractual agreement between two private persons, virtually all jurisdictions recognising trusts have purposely chosen not to regulate trusts like other corporate vehicles, such as corporations. This also means that, unlike corporations, there are no registration requirements or central registries and there are no authorities charged with overseeing trusts.<sup>21</sup> In many jurisdictions, however, the trust deeds of charitable trusts are enforced by the attorney general or an equivalent authority. In most jurisdictions, no disclosure of the identity of the beneficiary or the settlor is made to authorities.

One form of misuse of trusts is to conceal the existence of assets from tax authorities, creditors, ex-spouses, and other claimants or to conceal the identity of the beneficial owner of assets. Trusts often constitute the final layer of anonymity

for those seeking to conceal their identity. For example, the complex web of companies that former UK media mogul Robert Maxwell created to obscure ownership of assets was held together at the top by two trusts. Trusts can also be misused for money laundering purposes, particularly in the layering and integration stages (see Part I.D.1 (*Money laundering*) for definitions of these terms).

In addition, trusts may be used to perpetrate fraud. For example, settlors attempting to evade taxes may transfer assets into a trust and then falsely claim that they have relinquished control over the assets. To create this facade, a settlor will follow all of the formalities required to create a valid trust, such as setting up an irrevocable trust, appointing a third party trustee, and not naming himself as a beneficiary in the trust deed. However, despite adhering to the formal requirements of the law, settlors can still exercise control through the use of a letter of wishes and a protector. A letter of wishes, which often accompanies discretionary trusts, sets out the settlor's wishes regarding how he desires the trustee to carry out his duties, who the trustee should accept instructions from, and who the beneficiaries should be (which may include the settlor himself). While a letter of wishes is not legally binding on trustees, they usually follow the wishes expressed in the letter of wishes. To ensure that the trustee acts in accordance with the trust deed (and the letter of wishes), the trust laws of many common law jurisdictions provide for a "protector" to be named in the trust deed. The protector is appointed by the settlor and often is a trusted friend or advisor of the settlor. While the protector may not force the trustee to effectuate a distribution to a particular beneficiary, it may replace the trustee for any reason and at any time. Consequently, trustees that do not adhere to the trust deed and the letter of wishes can be quickly replaced.

Alternatively, settlors may transfer assets into an offshore trust in order to keep them out of the reach of creditors and other claimants (see *Anderson* case study). Once the assets are transferred into an offshore trust, it is very difficult and expensive to locate them and to identify their beneficial owners. Even if the trust assets are found, creditors will incur considerable time and expense in the attempt to repatriate the assets.

The ability to use trusts to conceal identity and to perpetrate fraud has been aided by the dramatic changes in recent years in the trust laws of some jurisdictions, the result of which is that trusts created under these laws bear little resemblance to the traditional common law trust. In certain jurisdictions, such as the Cook Islands, Nevis, and Niue, the trust law now allows the names of the settlor and the beneficiaries to be left out of the trust deed, permits settlors to retain control over the trust, sets aside the Statute of Elizabeth, recognises purpose trusts for non-charitable purposes, and permits trusts to have unlimited duration and to be revocable. In addition, the amended trust law typically permits the trust deed to include a "flee clause" (a provision that requires the assets of the trust

and information about the trust to be moved to another jurisdiction and new trustees to be appointed upon the occurrence of certain events, such as a service of process or change in legislation).

While trusts have always been attractive to protect assets from creditors and other claimants, certain jurisdictions, including many OFCs and several US states, have introduced “asset protection trusts” (APTs) that provide enhanced protection of assets from creditors. In the Cook Islands, one of the original APT jurisdictions, trusts may have unlimited duration, certain trusts that are otherwise invalid are deemed to be charitable, and a settlor can be a beneficiary and retain some control over the trust. In addition, neither foreign judgements nor foreign forced heirship rules<sup>22</sup> will be recognised. Lastly, a transfer into the trust is not deemed fraudulent if it occurs before a creditor’s cause of action has arisen or more than two years after the cause of action arose.

### 3. Foundations

A foundation is the nearest civil law equivalent to the common law trust. A foundation consists of property that has been transferred into it to serve a particular purpose and is a separate legal entity with no owners or shareholders. Foundations are ordinarily managed by a board of directors. Some civil law jurisdictions, such as Belgium and Poland, restrict foundations to public purposes (public foundations) while other jurisdictions, such as Austria, Denmark, Germany, Greece, Italy, Liechtenstein, the Netherlands, the Netherlands Antilles, Panama, and Switzerland, allow foundations to be established to fulfil private purposes (private foundations). In many civil law jurisdictions, a foundation may engage in commercial activities.

Ordinarily, foundations are highly transparent and highly regulated vehicles that are required to register with the authorities, file annual financial statements, and submit themselves to supervision by governmental authorities. In addition, there are safeguards in place to ensure that a foundation is sufficiently independent from its founder.

The likelihood of a foundation to be misused for illicit purposes increases when there is inadequate regulation or supervision over foundations or when founders are allowed to exert significant control over the foundation. In the Netherlands, which does not require prior consent of the government or a certificate of incorporation to establish a foundation, the authorities have reported that foundations are increasingly used for criminal purposes.<sup>23</sup>

In some civil law OFCs, foundations are not supervised, few public disclosures are required, founders are allowed to exert control over the foundation, and a high degree of anonymity is offered. In Panama, for example, government approval is not required for the establishment of a foundation or the amendment of its memorandum and there is no government agency that supervises founda-

tions. Furthermore, foundation documents containing the identity of beneficiaries (which may include the founder himself) are not required to be publicly filed and the foundation does not have to submit annual reports or accounts. The founder may also use a nominee to form the foundation, thereby ensuring that his identity is not revealed to the outside world.

The Liechtenstein foundation, in particular, has been alleged to have been frequently misused for illicit purposes, including to hide money of corrupt government leaders.<sup>24</sup> Liechtenstein also offers the *anstalt* (establishment), a corporate vehicle that is a hybrid between a private limited company and a foundation. The *anstalt*, which offers founders strong anonymity protection, grants founders effective control over the foundation, and mandates few disclosure requirements, is also perceived to be misused frequently for illicit purposes.

#### **4. Limited partnerships and limited liability partnerships**

A partnership is an association of two or more individuals or entities formed for the purpose of carrying out business activity. In contrast to corporations, traditional partnerships are entities in which at least one (in the case of limited partnerships) or all (in the case of general partnerships) partners have unlimited liability for the obligations of the partnership. In a limited partnership, the limited partners enjoy limited liability provided that they do not participate actively in management decisions or bind the partnership. In recent years, certain jurisdictions have introduced limited liability partnerships (LLPs) whereby all partners, regardless of the extent of their involvement in the management of the partnership, have limited liability. For tax purposes, partnerships are deemed to be flow-through vehicles that permit profits and losses to be allocated to, and taxed at, the partner level.

Given that traditional partnerships are generally used to structure private business relationships and that one or more partners have unlimited liability for the obligations of the partnership, these vehicles are generally less regulated than corporations. Lighter regulation provides partnerships with a more flexible structure. In general, partnerships do not appear to be misused to the same extent as other corporate vehicles. In a recent survey of corporate vehicles misuse in EU countries, no country mentioned partnerships as the most misused legal entity.<sup>25</sup>

Limited partnerships must be registered in order for the limited partners to benefit from limited liability. While many jurisdictions require limited and general partners of a limited partnership to be registered, other jurisdictions require the registration of the general partners only. In some jurisdictions, individuals or corporations may serve as general partners. In some jurisdictions, limited partners are not registered publicly and are allowed to influence management decisions, such as serving as an officer, director or stockholder of a corporate general partner and

advising the general partners on partnership business affairs, without losing their limited liability status or requiring registration with the authorities. The combination of anonymity with the ability to exert influence on management decisions may leave these types of limited partnerships vulnerable to misuse for illicit purposes.

LLPs must be registered with the authorities and a partner in an LLP enjoys limited liability protection except that he is personally liable for his own negligence, wrongful acts or misconduct and the negligence, wrongful acts or misconduct of those under his direct supervision and control.

Due to the availability of “charging order” protection, limited partnerships and LLPs can be used in asset protection schemes to defeat, or at least delay, the ability of a judgement creditor to lay claim on a debtor’s assets. With charging order protection, a creditor who obtains a judgement against a partner of a limited partnership may not foreclose on that partner’s interest in the partnership or any specific assets transferred into the partnership.<sup>26</sup> Rather, the creditor is only allowed to place a “charging order” on the partner’s interest so that any future distributions from the partnership will go to the creditor rather than the partner. The judgement creditor, however, may not force the partnership to make a distribution and if the partnership does not do so (a likely scenario since the debtor often controls the partnership) the creditor will not be able to satisfy his judgement. Furthermore, a creditor who has obtained a “charging order” may be considered, for tax purposes, a substitute partner in the partnership and must pay taxes on the debtor’s share of the partnership’s profits, even if no distributions are made.

### C. Mechanisms for Achieving Anonymity

The ability to obscure identity is crucial for perpetrators desiring to commit illicit activity through the use of corporate vehicles. While each of the corporate vehicles described above provides some degree of “natural” anonymity to its beneficial owner, anonymity can be enhanced through the use of a variety of mechanisms, such as bearer shares, nominee shareholders, and nominee directors. While these mechanisms were devised to serve legitimate purposes, they can also be misused to conceal the identity of the beneficial owners from the authorities. These instruments may also be used together to maximise anonymity. The risks posed by these mechanisms have led some authorities and other parties to develop counter measures in the attempt to neutralise their ability to obscure identity.

The primary instruments used to achieve anonymity are as follows:

#### 1. Bearer shares

Bearer shares are negotiable instruments that accord ownership of a corporation to the person who possesses the bearer share certificate. In other words, the person who has physical possession of the bearer share certificate is deemed to

be the lawful shareholder of the corporation that issued such bearer share and is entitled to all of the rights of a shareholder. Bearer shares do not contain the name of the shareholder and are not registered, with the possible exception of their serial numbers. Bearer shares are transferred by delivery of the share certificate, whereas registered shares are transferred by written instrument. Accordingly, bearer shares provide for a high level of anonymity and easy transferability.

In certain jurisdictions, bearer shares have common and legitimate use, such as to facilitate the transfer of shares and to avoid costs associated with the transfer of registered shares (stamp duties, expenses incurred through the use of a notary, cost of printing new registered share certificate, etc.). However, in certain jurisdictions and in certain commercial contexts, the high level of anonymity that bearer shares provide make them attractive for nefarious purposes, such as money laundering, tax evasion and other illicit conduct, especially when they are issued by private limited companies. Bearer shares are permitted in many (but not all) jurisdictions, both onshore and offshore. In many continental European jurisdictions, public limited companies are permitted to issue bearer shares while private limited companies are not allowed to do so. In certain OFCs, IBCs/exempt companies are allowed to issue bearer shares while domestic/resident companies are not.

Bearer shares are vulnerable to misuse because they can effectively obscure the ownership of a corporate vehicle, thereby providing maximum anonymity and making such corporate vehicles more susceptible to misuse for illicit purposes. For example, companies issuing bearer shares are usually exempt from having to maintain a share register with respect to those shares. This reduces the amount of information that the authorities may access in the event of an investigation.

Some OECD jurisdictions that permit the issuance of bearer shares have developed measures to counter the risks posed by these shares. In France, the Netherlands, and Spain, for example, a holder of bearer shares must register with the company or the authorities in order to exercise voting rights and receive dividends. France also “dematerialised” securities in 1981. As a consequence, physical share certificates no longer exist in France and shares and the identity of their holders are accounted for in the books of the company (for registered shares) or an authorised financial intermediary (for bearer shares).

Recognising the potential for obscuring the identity of the beneficial owner of a corporation, some offshore jurisdictions prohibit the issuance of bearer shares<sup>27</sup> while a few OFCs, such as the Bahamas and Cayman Islands, are moving toward eliminating bearer shares and/or introducing safeguards to ensure that these instruments are not abused. In Gibraltar, for example, an exempt company may issue bearer shares but they must be deposited in a Gibraltar bank and the names of the beneficiaries must be disclosed to the authorities. Furthermore, the custodian bank must confirm that they hold the bearer shares to the order of the

named beneficiaries and that no change in ownership will occur without the consent of the Financial and Development Secretary. These restrictions have resulted in very few exempt companies issuing bearer shares.

Measures have also been introduced in the private sector to curb the potential for misusing bearer shares. Prompted in part by anti-money laundering legislation requiring certain intermediaries to identify their customers and in part by suspicion of clients who insist on using bearer shares, some corporate service providers immobilise the bearer shares held by their clients to ensure that such shares are not subsequently transferred without their knowledge.

## **2. Nominee shareholders**

Nominee shareholders are utilised in most jurisdictions. With respect to publicly traded shares, nominees (*e.g.*, registering shares in the names of stockbrokers) are commonly, and legitimately, used to facilitate the clearance and settlement of trades. The rationale for using nominee shareholders in other contexts, however, is less persuasive and may lead to abuse. For example, many jurisdictions require corporations to maintain shareholder registers and file annual returns containing a shareholders list and directors information. The use of nominees, however, reduces the usefulness of the shareholder register or the shareholder list because the shareholder of record may not be the ultimate beneficial owner.

Where nominee shareholders are used, most jurisdictions employ investigatory means (*e.g.*, questioning the record holder) to discover the identity of the beneficial owners. In the United Kingdom, Section 212 of the Companies Act 1985 provides companies with a procedure to identify the beneficial owners of their shares. Under this Section, a company can ask the nominee to disclose the identity of the beneficial owner. If the nominee refuses, the company can apply sanctions such as suspending voting rights, withholding dividends, or refusing to register any subsequent transfer of shares.

## **3. Nominee directors and “corporate” directors**

Nominee directors and corporations serving as directors (“corporate directors”) can also be misused to conceal the identity of the beneficial owner, and their use renders director information reported to the companies registry less useful. Nominee directors appear as a director on all company documents and in official registries (if any) but pass on all duties required to be performed by a director to the beneficial owner of the company. In many jurisdictions, the nominee or corporate director is not required to own shares in the company in which it serves as a director.

Certain jurisdictions, including most OECD Member countries and OFCs such as Cyprus, Isle of Man, Jersey, Malta, and the Netherlands Antilles, do not recognise nominee directors. Consequently, a person who accepts a directorship is subject to all of the requirements and obligations of a director, including fiduciary obliga-

tions, notwithstanding the fact that he is acting as a nominee. In certain jurisdictions, directors cannot be indemnified by the beneficial owner. Non-recognition of the concept of nominee director has one indirect benefit – those furnishing or acting as professional directors are likely to take greater precautions to ensure that their client, the beneficial owner, does not misuse the corporate vehicle for illicit purposes. In the Netherlands Antilles, which does not recognise the concept of nominee directors, reputable trust companies that are asked to serve as directors will conduct a rigorous background check on their clients and, in the case of bearer share companies, will insist on the immobilisation of those shares as a condition to accepting a directorship. To curb the availability and use of nominee directorships, certain jurisdictions, such as Ireland, impose a limit on the number of directorships a person may hold. In Ireland, a person may hold a maximum of 25 directorships. In the United Kingdom, the Companies Act requires disclosure of the identity of “shadow” directors, who are defined as persons on whose instructions the directors of a company are accustomed to act.

“Corporate” directors are used in many jurisdictions. Some jurisdictions, including Australia, Denmark, Hungary, Ireland, Jersey, Panama, and Switzerland, do not permit corporations to act as directors while other jurisdictions, such as the Netherlands, United Kingdom, and many OFCs, recognise corporate directors.<sup>28</sup> Corporate directors may be a device that facilitates the abuse of corporate vehicles if the legal system cannot timely and effectively assign director responsibility to physical persons for illicit corporate behaviour.

#### **4. Chains of corporate vehicles**

Perpetrators of illicit activities frequently employ a chain of corporate vehicles, each established in a different jurisdiction (particularly those where beneficial ownership information is not maintained, readily obtainable, or able to be shared), to maximise anonymity and to make it very difficult for authorities to trace beneficial ownership.<sup>29</sup> For example, an IBC in jurisdiction X may be owned by another IBC in jurisdiction Y, which in turn is owned by a third IBC in jurisdiction Z. The third IBC may then be owned by a trust established in yet another jurisdiction. The possible permutations are virtually limitless. For example, former Australian billionaire Alan Bond was alleged to have used a variety of corporate vehicles in different jurisdictions to hide assets from his creditors. Tracing of beneficial ownership proved to be so difficult that, in the end, Bond's creditors opted to accept a settlement of A\$ 10.25 million on debts totalling more than A\$ 1 billion (see *Alan Bond* case study for further details).

#### **5. Intermediaries – company formation agents, trust companies, lawyers, trustees, and other professionals**

Intermediaries, such as company formation agents, trust companies, lawyers, trustees, and other professionals, play an important role in the formation and



management of corporate vehicles in most OFCs. While such intermediaries exist in onshore countries, they assume a less prominent role than their offshore counterparts. Moreover, intermediaries in OFCs often play a key role in obscuring the identity of the beneficial owners of corporate vehicles.

Corporate service providers regularly design structures to ensure that the beneficial owner remains anonymous and often act as the intermediary between the client and the authorities in the jurisdiction of incorporation. Furthermore, they routinely supply nominee shareholders and nominee directors so that the beneficial owners' names do not appear on any company or official records. Other intermediaries, such as private banks that cater to high net worth individuals, have also been known to establish shell entities to help their clients conceal their identities.

The laws of many jurisdictions exempt financial institutions from having to conduct due diligence on clients referred by an intermediary (such as a lawyer, notary, or licensed corporate service provider) who has declared that it has ascertained the identity of the client. In these jurisdictions, intermediaries are often used to establish bank accounts in order to enable the beneficial owner to remain anonymous. Even where an exemption is not provided under the law, some financial institutions may not undertake independent due diligence if an intermediary vouches for the client, thereby allowing the client to remain unidentified.

Trustees may also play a role in obscuring the identity of the beneficial owner. In certain jurisdictions, where a trust holds shares in a company, the trustee appears as the record holder and he does not have to disclose that he is holding the shares as a trustee. This can mislead authorities into believing that the trustee is the true owner of the shares.

Lawyers, notaries, and others with professional confidentiality privileges are particularly attractive intermediaries because the identity of their clients can sometimes be protected from disclosure. In certain jurisdictions, the law grants professionals such as lawyers and notaries the right to refuse to give evidence to the authorities, even when these professionals were acting in a non-legal capacity. Some offshore jurisdictions extend this privilege to management companies.

#### **D. Types of Illicit Activities Perpetrated Through the Use of Corporate Vehicles**

This section examines the primary types of illicit activities committed through the use of corporate vehicles.

## 1. Money laundering

The basis of money laundering is that people who commit crimes need to disguise the origin of their criminal money so that they can protect it from seizure and use it more easily. Money laundering is the process whereby proceeds from illicit activities undergo a transformation (“laundered”) so that, at the end of the laundering process, they appear to have been derived from legitimate activities.<sup>30</sup> In essence, money laundering constitutes the last stage in the commission of illicit activity. The underlying offences that give rise to the need to launder money include drug and human trafficking, extortion, bribery, insider trading, arms trafficking, credit card fraud, illicit tax practices, kidnapping, market manipulation, and other criminal offences.<sup>31</sup>

According to the FATF, money laundering involves a three-stage process: *placement* (introducing illegal profits into the legal financial system or smuggling them out of the country), *layering* (separating proceeds from its source through a series of transactions (using a number of vehicles in various jurisdictions) designed to distance them from their source), and *integration* (reintroducing the laundered funds back into the economy). In all three stages, corporate vehicles may be misused.

The need to launder money arises from virtually all profit-generating crimes. Consequently, money laundering can, and does, occur in practically all jurisdictions. Money launderers, however, prefer using jurisdictions that enable them to avoid detection. Strict secrecy laws, lax regulatory and supervisory regimes, and the availability of corporate vehicles with impenetrable anonymity features in certain OFCs attract money launderers to these jurisdictions. In particular, IBCs incorporated in some jurisdictions are routinely used to launder money because they provide “an impenetrable layer of protection around the ownership of assets”.<sup>32</sup> Meanwhile, the political stability, large economy, and sophistication of the financial services sectors in many developed countries also make these jurisdictions, and their corporate vehicles, vulnerable to money laundering.

Money laundering schemes frequently involve the use of corporate vehicles in both onshore and offshore jurisdictions. For example, gains from criminal activity in an onshore jurisdiction will be transferred first to an offshore bank account opened in the name of an OFC-established corporation. The funds will then be moved through various jurisdictions (both onshore and offshore), again through the use of corporate vehicles, to distance them from their illicit source. Lastly, to bring money back into the home jurisdiction, a domestic company is established to “borrow” money from the offshore entity.

To attain greater legitimacy and to reduce the risk of detection, money launderers seek to exploit existing companies that have established banking relationships with overseas financial institutions. These businesses provide credible

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explanations for their deposit levels and cross-border fund transfers. Exploiting established firms is also attractive because some jurisdictions that have recently introduced customer identification requirements provide an exemption for existing clients (see *Anti-Money Laundering Laws* (Part II.C.1.b) for a more detailed discussion of customer identification requirements).

A number of the illicit practices described below involve money laundering at some level. They are discussed separately in order to provide a clearer picture of the types of illicit activities that occur through the misuse of corporate vehicles.

## **2. Bribery/corruption**

Corporate vehicles may also be misused in bribery/corruption transactions. According to the FATF, shell companies and nominees are frequently misused by bribe donors and recipients to facilitate their illicit transactions.<sup>33</sup> For example, French oil company Elf Aquitaine was alleged to have funnelled bribes to Gabon president El Hadj Omar Bongo through his Swiss bank accounts opened in the names of offshore shell corporations.<sup>34</sup>

Foundations and trusts are also frequently misused for corruption and bribery. For example, it has been widely reported that former Philippine President Marcos used Liechtenstein corporate vehicles, including foundations, to facilitate his corrupt practices.

## **3. Hiding and shielding assets from creditors and other claimants**

Corporate vehicles can also be misused to hide and shield assets from creditors and other claimants, such as spouses, heirs, and tax authorities. The obscurity provided by certain types of corporate vehicles can be exploited to conceal the existence or ownership of assets in order to keep them out of the reach of creditors and other claimants. In some bankruptcy cases involving individuals, for example, funds have been siphoned out of one jurisdiction through shell companies and trusts incorporated in other jurisdictions where it was extremely difficult to trace beneficial ownership (see *Alan Bond* case). In certain jurisdictions, where a trust holds shares in a company, the trustee appears as the record holder and does not have to disclose the fact that he is holding the shares as a trustee.

Trusts, particularly asset protection trusts, can also be misused to shield assets from creditors and other claimants. Settlers who transfer assets into a trust to avoid creditors and other claimants seek to give the appearance that they no longer own, or exercise control over, the transferred assets (see *Anderson* case). That way, the transferred assets (provided that they do not violate fraudulent conveyance laws) will not be reachable by creditors. However, although the settlers may have followed all of the formal requirements to create a valid trust, they may secretly exert control over the trust and trustee through letters of wishes and protectors.

As noted previously, charging order protection provided to LLCs and partnerships also make them attractive vehicles to delay and impair the ability of judgment creditors to seize a debtor's assets.

#### **4. *Illicit tax practices***

Illicit tax practices, such as profit skimming, double invoicing, transfer pricing abuses, and diversion of income, can be carried out through the use of corporations and trusts established in foreign jurisdictions. The US Internal Revenue Service has noted a proliferation in the use of OFC trusts and corporations in tax evasion schemes due to the difficulty in tracing their beneficial owners.<sup>35</sup>

Numerous schemes can be devised to perpetrate illicit tax practices. For example, a taxpayer wishing to divert income from his domestic business could establish a company in a foreign jurisdiction to issue false invoices to the taxpayer's domestic business. The taxpayer would record and report the payments made pursuant to the fake invoices as expenses, for the purpose of lowering the reported business' profits and, more importantly, taxes.

Once assets are secreted abroad, mechanisms are then devised to access and use such funds. "Repatriation" can be accomplished through the use of a corporate vehicle. For example, if the transfer of assets was initially achieved through the use of a foreign trust, the trust can thereafter transfer the funds to the bank account of a bearer share company, which would then extend a loan to the taxpayer. The use of bearer shares and other anonymity enhancing instruments makes it difficult for tax authorities to prove that such a loan is fraudulent.

As discussed previously, individuals may, through the use of a trust, attempt to conceal the existence of assets and income from tax authorities. In addition, trusts may be used in a fraudulent manner (sham trust) to deceive tax authorities that a real transfer of assets has occurred when, in fact, effective control remains with the settlor.

#### **5. *Self-dealing/defrauding assets/diversion of assets***

Corporate vehicles, particularly those established in jurisdictions where the ownership of the corporate vehicle can be obscured, may be abused by those engaging in self-dealing and defrauding of assets. The use of corporate vehicles may provide a facade of legitimacy (*e.g.*, arm's length dealing) to an otherwise improper transaction between related parties in a corporation. The use of bearer shares and nominee directors, in particular, makes it very difficult for authorities to prove that a transaction constitutes unlawful self-dealing or illegal diversion of assets.

These abuses are especially found in transition economies, such as Russia. One commentator noted that “virtually every Russian enterprise, big or small, is surrounded by ‘independent’ companies set up by managers or their families; in many cases, sales and purchasing contracts are structured to go through these firms, raking off profits from the main enterprise”.<sup>36</sup> A significant portion of these and other illegal capital flight activities have been carried out through the use of foreign-incorporated corporate vehicles, contributing to the billions of dollars that flow out of Russia annually. In addition, the use of corporate vehicles for self-dealing purposes has also been common in certain Asian jurisdictions.

#### **6. Market fraud and circumvention of disclosure requirements**

As with other types of illicit activities, corporate vehicles can also be misused to engage in market fraud and to circumvent disclosure requirements. For example, insiders of publicly traded corporations have been able to abuse their access to material, non-public information by using corporations established in foreign jurisdictions to carry out illicit buying and selling of shares. Recently, Italian authorities have observed the frequent use of corporate entities established in countries where beneficial ownership is difficult to detect to engage in insider dealing. In addition, individuals have been able to use the anonymity provided by certain corporate vehicles to hide their control of entities that are being used to manipulate the market for publicly traded securities. In particular, perpetrators may use corporate entities to spread false or misleading information in order to distort market prices or to conduct fraudulent buying and selling activities to artificially inflate share prices. Lastly, individuals may evade requirements to report shareholdings in a company above certain threshold levels (*e.g.*, 5% or 10% of the outstanding shares) by distributing those shares among a group of corporate vehicles, with each vehicle holding less than the threshold amount.

## Notes

1. 2000 EC Legal Persons Report, p. 11.
2. Transcrime, *Euroshore: Protecting the EU financial system from the exploitation of financial centres and off-shore facilities by organised crime*, January 2000, p. 118 (“Euroshore Report”).
3. OECD Committee on Fiscal Affairs, *Improving Access to Bank Information for Tax Purposes*, 2000, p. 11.
4. United Nations Office for Drug Control and Crime Prevention, “Financial Havens, Banking Secrecy and Money-Laundering”, 1998, p. 57 (“1998 UN Report”).
5. Financial Action Task Force on Money Laundering, *Report on Non-Cooperative Countries and Territories*, 14 February 2000, p. 4.
6. Sue Hawley, *Exporting Corruption: Privatisation, Multinationals and Bribery*, June 2000, at: [www.globalpolicy.org/nations/corrupt/corner.htm](http://www.globalpolicy.org/nations/corrupt/corner.htm).
7. Most jurisdictions maintain only a single-tiered board consisting of a board of directors. Other countries employ two-tiered boards consisting of a supervisory board and a management board.
8. Powers granted to shareholders usually include the right to elect directors, to participate and vote in general shareholders meetings, and to approve extraordinary transactions that effectively result in the sale of the company.
9. The term “shares” as used in this Report includes shares, interests, parts, and other forms of ownership in a corporation.
10. In civil law jurisdictions, public limited companies include the *société anonyme* (SA) and the *Aktiengesellschaft* (AG).
11. In civil law jurisdictions, private limited companies include the *société à responsabilité limitée* (SARL) and the *Gesellschaft mit beschränkter Haftung* (GmbH).
12. Some common law jurisdictions, such as Ireland and the United Kingdom, allow private limited companies to issue bearer shares.
13. 2000 EC Legal Persons Report, p. 7, 113, 116.
14. United Kingdom Cabinet Office Performance and Innovation Unit, *Recovering the Proceeds of Crime*, June 2000.
15. FinCEN, *The SAR Activity Review – Trends, Tips and Issues*, October 2000.
16. United States Department of State, International Narcotics Control Strategy Report 1999, March 2000 (“INCSR 1999”). A shelf company is a company that has already been incorporated with a standard memorandum and articles of association and has inactive shareholders, directors, and secretary. When a shelf company is subsequently purchased, the inactive shareholders transfer their shares to the purchaser and the directors and secretary submit their resignations. Typically, the authorities do not need to be notified when a shelf company is sold.

17. In Delaware, for example, LLCs are unique in that managers can be corporate entities. In contrast, only a natural person can serve as a director or officer of a Delaware corporation. Furthermore, if the Delaware LLC elects to be treated as a partnership and the members of the LLC comprise solely non-US persons, annual tax returns are not required but partners may still have the obligation to file tax returns reporting partnership income.
18. Even though a number of civil law jurisdictions recognise the concept of trust, the discussion in this section refers (unless indicated otherwise) to the common law concept of trust, since trusts established in common law jurisdictions (with a few exceptions) appear to be misused most frequently.
19. The settlor may also be a beneficiary.
20. In some jurisdictions, the settlor can serve as co-trustee.
21. Trusts that engage in financial services activities, such as unit trusts that pool funds from the general public, are often regulated. In Japan, a civil law jurisdiction, the court supervises all private trusts except trusts engaged in commercial business.
22. In some countries, the law prescribes the manner in which a person's estate must be distributed ("forced heirship").
23. EC Legal Persons Report, p. 116.
24. For example, it has been widely reported that former Philippine President Ferdinand Marcos used a number of Liechtenstein foundations to hide money stolen from the Philippine treasury.
25. 2000 EC Legal Persons Report.
26. This is based on the theory that assets transferred into a partnership are assets of the partnership rather than of the individual partners.
27. Jurisdictions that prohibit the issuance of bearer shares include Barbados, Bermuda, Costa Rica, Cyprus, Guernsey, and Jersey.
28. In Italy, there is a *de facto* prohibition on a corporation serving as a director of another corporation.
29. The use of groups of corporate vehicles may also enhance obscurity if rules on the disclosure of group activities are non-existing or inadequate.
30. In addition, money laundering offences also include the concealment of the proceeds of crime.
31. Different jurisdictions have different predicate offences for money laundering. Some jurisdictions have "all crimes" laws that criminalise the laundering of money derived from all serious crimes.
32. 1998 UN Report, p. 60.
33. Financial Action Task Force on Money Laundering, *Report on Non-Cooperative Countries and Territories*, 14 February 2000, p. 4.
34. United States Senate, Minority Staff Report for Permanent Subcommittee on Investigations, *Hearing on Private Banking and Money Laundering: A Case Study of Opportunities and Vulnerabilities*, 9 November 1999 (citing various reports regarding Swiss authorities freezing bank accounts, including two accounts opened in the name of shell corporations, linked to President Bongo at the request of French authorities who were investigating bribes paid by Elf Aquitaine).

35. Internal Revenue Service (United States), Summary of Abusive Trust Schemes, October 2000, p. 3.
36. Patricia Kranz, *Shareholders at the Gate*, Business Week, 2 June 1995, at 60 (in Merritt B. Fox and Michael A. Heller, Lessons from Fiascos in Russian Corporate Governance, University of Michigan Law School, Law and Economics Working Paper No. 99-012, October 1999).

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## Part II

# Obtaining and Sharing Information on Beneficial Ownership and Control

### A. Introduction

To prevent and combat the misuse of corporate vehicles for illicit purposes, it is essential that the authorities in all jurisdictions have the means to obtain and share, on a timely basis, information on the beneficial ownership and control of corporate vehicles established in their jurisdictions.

Jurisdictions employ a variety of mechanisms to obtain information on beneficial ownership and control. Most jurisdictions rely on compulsion power, court-issued subpoenas, and other measures to penetrate the legal entity in order to identify the beneficial owners when illicit activity is suspected.<sup>1</sup> In a small number of jurisdictions, the authorities require extensive disclosure of beneficial ownership and control to the authorities at the formation stage and some impose an obligation to update such information when changes occur. A growing number of jurisdictions are also supplementing the above approaches by requiring intermediaries involved in the formation and management of corporate vehicles to obtain, verify, and retain records on beneficial ownership and control, and to grant authorities access to such records for the purpose of investigating illicit activities, fulfilling their regulatory/supervisory functions (see Part B below for further details), or sharing with other domestic and foreign authorities.

While a number of options are available for obtaining beneficial ownership and control information, not all options are suitable for all jurisdictions. Depending on their particular circumstances (as discussed in Part III), certain jurisdictions may need to adopt a more extensive, up front disclosure mechanism while other jurisdictions may be able to rely primarily on an investigative or other mechanisms for obtaining beneficial ownership and control information. A number of factors influence the choice of mechanism for obtaining information on beneficial ownership and control, including the nature of business activity in a jurisdiction, extent and character of non-resident ownership, corporate regulatory regime, existing anti-money laundering laws, powers and capacity of supervisors and law enforcement

authorities to obtain beneficial ownership and control information, functioning of the judicial system, and availability of anonymity instruments. In addition, policy-makers must find an appropriate balance between ensuring proper monitoring/regulation of corporate vehicles and protecting legitimate privacy interests. In jurisdictions with a substantial domestic commercial sector and where existing investigative mechanisms function well, policymakers must also take into account the risk that an extensive, up front disclosure system may impose unnecessary costs or burdens on corporate vehicles, particularly smaller enterprises.

The ability of authorities to obtain information on beneficial ownership and control must also be accompanied by a corresponding capacity to share that information with other authorities domestically and internationally respecting each jurisdiction's own fundamental legal principles. The ability to share information among domestic authorities is important because certain authorities in a jurisdiction may possess, or have better access to, beneficial ownership and control information that is required by other domestic authorities for supervisory or law enforcement purposes. Given that anonymity can be enhanced through the use of corporate vehicles incorporated in foreign jurisdictions, it is equally critical that the authorities in one jurisdiction also have the ability to share information on beneficial ownership and control with authorities in other jurisdictions.

Information on beneficial ownership and control may be shared through a number of mechanisms, ranging from formal mechanisms, such as mutual legal assistance treaties (MLATs) and memoranda of understanding (MOUs), to less formal arrangements and *ad hoc* assistance.

## **B. Who Needs Information on Beneficial Ownership and Control?**

Numerous authorities may have a recognisable legal interest in obtaining information on beneficial ownership and control in order to investigate suspected illicit activities. Law enforcement authorities investigating and prosecuting money laundering and other crimes, tax authorities verifying compliance with tax laws, and securities regulators investigating market manipulation, unlawful insider trading, and fraud are just some of the authorities who may require information on beneficial ownership and control. Courts may also need such information in the context of corporate self-dealing and other litigation cases. In addition, other officials appointed by or acting under the supervision of the government, such as insolvency administrators, may also require such information.

Information on beneficial ownership and control may also be required for regulators/supervisors to effectively carry out their regulatory/supervisory responsibilities. For example, bank regulators may require access to individual client account information (including beneficial ownership and control information of accounts opened under the names of corporate entities) held by regulated enti-

ties to monitor compliance with customer identification requirements. Information on beneficial ownership and control may also enable regulators to determine people or entities who may be in a position to effect a market manipulation or who will likely stand to gain significantly from a manipulation.

### C. Issues Impacting the Ability of Authorities to Obtain and Share Beneficial Ownership and Control Information

The ability of authorities to obtain and share information on beneficial ownership and control is influenced by a number of factors. Some of the issues that impact the ability of authorities to obtain and share information on beneficial ownership and control are described below:

#### 1. *Legal rules*

##### a) *Company law and other related laws*

A country's company law and other related laws, depending on their particular features, can impact the ability of authorities to obtain and share information on beneficial ownership and control. In essence, company and trust laws that allow for, encourage, or mandate low transparency in corporations and trusts seriously impede the ability of authorities to identify the beneficial owners of corporate vehicles and increase their vulnerability to misuse for illicit purposes.

##### i) *Company law*

The issues governed under the company law that impact the capacity of authorities to obtain information on beneficial ownership and control include, but are not limited to:

- Availability of bearer shares.
- Recognition of nominee shareholders and nominee directors.
- Availability of "corporate" directors.
- Residency requirements of directors.
- The local presence requirement.
- Requirement to maintain shareholder register.
- Maintenance of shareholder registers in jurisdiction of incorporation.
- Annual reporting requirements; and
- Location where books and records are to be maintained.

As stated earlier, many jurisdictions permit the use of bearer shares. In general, the use of bearer shares reduces the availability of records that authorities

can access to ascertain beneficial ownership and control. In many countries, companies are required to maintain share registers only with respect to registered shares. Moreover, transfers of bearer shares do not have to be registered in the share register while transfers of registered shares must be recorded in the share register. However, in certain countries, such as France and Spain, holders of bearer shares must disclose their identity to the company in order to exercise their voting rights. In France, the tax authorities require holders of bearer shares to disclose their identity in order to receive dividends.

A number of jurisdictions recognise the concept of nominee shareholders while fewer jurisdictions permit the use of nominee directors. As stated above, the use of nominees reduces the usefulness of shareholder registers and director information (filed publicly or maintained by the corporation) for the purpose of identifying beneficial owners and controlling persons. Likewise, the availability of “corporate” directors makes it more difficult for authorities to obtain information on the control of a corporate vehicle.

The availability of a physical person (manager or director) with real ties (*i.e.*, non-nominees) to the company in the jurisdiction of incorporation may enhance the capacity of regulators/supervisors and law enforcement officials to obtain information on a company under investigation. In many jurisdictions, however, officers and directors of corporate entities are not required to reside in the jurisdiction of incorporation. In some jurisdictions that require resident directors, widespread use of nominees means that the authorities may not be able to rely on these individuals to supply them with substantive information on the company.

Most jurisdictions also mandate either a registered office or a registered agent in the jurisdiction of incorporation. However, in some jurisdictions, the registered office of a company could just be a “letter box” where official documents are sent. Likewise, a registered agent may not have any substantive knowledge of the company.

Many jurisdictions also require companies to maintain an up-to-date shareholder register and/or to lodge a shareholders list with the authorities when filing their annual returns. In many jurisdictions, such information is made available to the public (including via the Internet). In certain jurisdictions, the shareholder register is not available to the public or restrictions are placed on its access by the public, although in some jurisdictions such information is easily obtainable by subpoena. Moreover, the frequent use of nominees means that beneficial ownership information may not be directly available through this channel. In many offshore jurisdictions, the share register is not required to be deposited with the authorities.

Some jurisdictions, even when they require a local registered office or agent, do not require books and records (including shareholder registers) to be kept in the jurisdiction of incorporation.<sup>2</sup> The inaccessibility of such records in

the jurisdiction of incorporation impedes the ability of authorities to obtain relevant information about the company. UK authorities have acknowledged that when the books and records of UK-registered companies are kept outside of the United Kingdom, they have experienced difficulties responding to requests from foreign authorities for information on those companies.

ii) Trust law (*see Part I.B.2 for a general discussion of trusts*)

The concept of a trust and the trust law in some jurisdictions may create difficulty for authorities attempting to obtain beneficial ownership information. The primary characteristic of a trust, the separation of legal ownership from beneficial ownership, gives rise to the potential for anonymity because the beneficial owner may be able to hide behind the “cover” provided by the legal owner. Given the private nature of trusts and the fact that a trust is essentially a contractual agreement between private persons, virtually all jurisdictions recognising trusts have purposely chosen not to regulate trusts like other corporate vehicles, such as corporations. This means that, unlike corporations, there are no registration requirements or central registries<sup>3</sup> and there are no authorities charged with overseeing trusts.<sup>4</sup> In many jurisdictions, however, the trust deeds of charitable trusts are enforced by the attorney general or an equivalent authority. In most jurisdictions, no disclosure of the identity of the beneficiary or the settlor is made to the authorities.

As discussed earlier, the trust law has been amended considerably in some jurisdictions (particularly OFCs) in recent years. In some cases, the changes have made it more difficult for the authorities to uncover the identity of the beneficial owner or the settlor. In some jurisdictions, the trust law permits the trust deed to include a “flee clause”, which requires trustees to change the governing law of the trust, move the trust’s assets and documents to another jurisdiction, and appoint a new trustee in a different jurisdiction upon the occurrence of certain events or whenever the trust is threatened (*e.g.*, service of process, change of legislation, or an inquiry for information by the authorities).

In certain jurisdictions, the authorities have introduced measures to make beneficial ownership information of trusts easier to obtain. For example, some jurisdictions require professional trustees to identify the beneficial owner and to grant authorities access to such information in the event of an investigation. Furthermore, a few jurisdictions, including Bermuda, Cyprus, and Jersey, require the disclosure of the beneficial owners of trusts when a trust holds shares of companies registered in these jurisdictions.

iii) Other laws

Other laws may also influence the ability of authorities to obtain and share information on beneficial ownership and control. Most fundamentally, the laws in

some jurisdictions do not permit the authorities to 1) share non-public information with other domestic and foreign authorities, 2) co-operate in criminal matters where the alleged offence does not constitute a crime in the jurisdiction where assistance is sought, or 3) undertake investigations on behalf of foreign authorities. Increasingly, the authorities in various jurisdictions are obtaining powers that enhance their capacity to co-operate with other authorities. For example, since 1988, the US Securities and Exchange Commission (SEC) has been able to use its compulsory powers to obtain information requested by foreign authorities regardless of whether there was an independent basis for suspecting a contravention of US laws. Many other authorities, including those in Australia, France, and Singapore, have obtained similar authority.

In some jurisdictions, tax authorities are required to inform the affected taxpayer when foreign authorities request information relating to that taxpayer. Some of these countries, however, provide an exemption in the case of tax fraud. While the requirement to notify the affected taxpayer may be appropriate from the perspective of due process (so that the taxpayer can lodge an appeal in court against any decision to permit the exchange of information), it can also result in considerable delays in the provision of information.

*b) Anti-Money Laundering Laws*

Information gathered under customer identification requirements of anti-money laundering laws may enhance the ability of the authorities to obtain information on beneficial ownership and control. Provided that there is full compliance and provided that the information gathered can be accessed and shared by the authorities for regulatory/supervisory and law enforcement purposes, the customer identification scheme may serve as an effective mechanism for the authorities in jurisdictions that do not require up front disclosure to obtain information on the beneficial ownership and control of corporate vehicles.

Customer identification requirements under anti-money laundering laws obligate financial institutions to identify their clients and to maintain and update identification records. In some jurisdictions, this obligation extends to other institutions and professionals, such as company formation agents, trust companies, lawyers, and notaries (“covered parties”).<sup>5</sup> Such customer identification requirements, if interpreted in accordance with the FATF Forty Recommendations, would compel financial institutions and any other covered parties to ascertain the beneficial ownership of corporate vehicles.<sup>6</sup>

Relying on anti-money laundering laws to obtain beneficial ownership and control information may not produce the outcome described above when customer identification requirements are not sufficiently strict or when there is difficulty in achieving full compliance. For instance, at the most basic level, a few

jurisdictions still do not have any customer identification requirements in place. In addition, many countries apply customer identification requirements only to financial institutions. While a number of jurisdictions extend customer identification requirements to company and trust service providers, lawyers, and others, some of them exempt these parties from having to undertake independent due diligence if a client is introduced by certain specified intermediaries. This exemption may be a cause for concern.

Furthermore, certain jurisdictions that have recently introduced or modified their customer identification requirements provide exemptions for existing clients. In the Isle of Man, for example, financial institutions and other covered parties are exempt from applying the new customer identification requirements to clients who opened their accounts or established their relationships prior to December 1998. Similar exemptions also exist in Jersey and Guernsey. Recently, the authorities in Guernsey, Isle of Man, and Jersey have proposed requiring financial institutions and other covered parties to obtain documentary evidence of identity for such exempted clients, with a view to completion in a period of five years.

In order to effectively combat and prevent the misuse of corporate vehicles for illicit purposes, beneficial ownership and control information held by financial institutions and other covered parties must be made accessible to the authorities. A recent OECD report remarked that the FATF recommendations on identification of clients, including corporate clients, “enhances the information potentially available for other law enforcement purposes if access to that information is permitted by law”.<sup>7</sup> Unfortunately, some jurisdictions do not permit access to such information by authorities, particularly regulatory authorities.

c) *Bank and corporate secrecy laws*

Bank and corporate secrecy laws typically impose civil and criminal penalties for unauthorised disclosure of confidential information, including information on the beneficial ownership and control of corporate vehicles. These laws diminish the capacity of authorities to obtain and share beneficial ownership and control information when they do not provide mechanisms for domestic and international authorities fulfilling their regulatory/supervisory or law enforcement functions to access records (including those required to be maintained under the company law and other related laws) and persons who can identify the beneficial owners and controllers of corporate vehicles.

Individuals and corporate vehicles have legitimate expectations of privacy and business confidentiality in their affairs. Corporate entities, in particular, have a valid right not to have their affairs disclosed to competitors, customers, and suppliers, among others. Furthermore, privacy is an important matter for certain

classes of individuals, particularly those with significant net worth or who occupy high profile positions, who are vulnerable to extortion and kidnapping. Nonetheless, the need to protect legitimate privacy interests does not justify denying authorities access to relevant information when illicit activity is suspected.

In some countries, strict secrecy laws deny authorities access to information on a person or legal entity unless the affected person gives its consent. In the Cook Islands, for example, corporate records can be examined in the Companies Office Registry only if the corporation gives its consent.

The strict secrecy laws in some jurisdictions restrict the authorities' access to information even when illicit activity is suspected. In Nauru, for example, secrecy laws prohibit the inspection of holding corporation records for regulatory and enforcement purposes. In addition, jurisdictions with strict secrecy laws may also proscribe the sharing of information among domestic as well as international authorities.

Even where secrecy protection may be lifted under certain circumstances, the potential delays stemming from having to comply with the requisite procedures may impede investigations (*e.g.*, inability to obtain information and records, lapse of statutes of limitations, etc.) and allow the perpetrators to move their assets to a different jurisdiction. Furthermore, bank secrecy is often lifted only in the event of a criminal investigation, thereby providing access to information to criminal law enforcement officials but not to regulatory authorities performing regulatory/supervisory or law enforcement functions.

## **2. Institutional infrastructure and availability of financial and human resources**

A country's institutional infrastructure and availability of financial and human resources are relevant for assessing the capacity of the authorities to obtain and share information on beneficial ownership and control.

Although a regulatory framework for companies exists in nearly all jurisdictions, the ability of the authorities to perform effective regulatory/supervisory functions vary considerably across jurisdictions, owing to, among other things, the lack of resources and weak enforcement powers. While the authorities in most jurisdictions face some constraints regarding their ability to obtain beneficial ownership and control information, the problems encountered by the authorities in some OFCs appear to be most acute. In a few OFCs there are no supervisory authorities to monitor the offshore sector. In some jurisdictions, such as the Marshall Islands, Niue, and St. Lucia, regulatory/supervisory functions have been largely delegated to the private sector.<sup>8</sup>

In certain OFCs, the domestic authorities have weak enforcement powers. For example, regulators/supervisors in some jurisdictions lack the ability to obtain information and documents (including information on the beneficial ownership



and control of corporate vehicles) from licensees and entities located or operating in their jurisdictions. In St. Vincent and the Grenadines, there are no mechanisms available to the Offshore Finance Authority to ensure compliance with laws and regulations by offshore entities. In contrast, an assortment of authorities in the United Kingdom<sup>9</sup> are empowered, pursuant to statutory and non-statutory duties, to seek information on beneficial ownership of shares. The US Securities and Exchange Commission (SEC), in any matter relating to securities fraud, has the power to compel testimony and the production of documents from anyone in the United States, including individuals and privately held and publicly traded companies, regardless of whether they are regulated by the SEC. The Cayman Islands Monetary Authority (CIMA) was recently given the power to compel information, including client information, that it reasonably requires for its regulatory functions from licensees, persons connected with licensees, and other persons who have relevant information. Previously, CIMA could access client information maintained by banks only if the affected client consented.

In some jurisdictions, government agencies charged with oversight of the corporate and financial sectors are drastically underfunded and understaffed. In Grenada, the Financial Services Authority suffers from severe understaffing. In Aruba, the financial intelligence unit is reputed to have a capable and dedicated personnel but its effectiveness is hampered by insufficient staffing.

The lack of resources also plagues some onshore jurisdictions. For example, prior to recent reforms, Irish authorities did not possess sufficient resources to ensure compliance with the annual return requirement. In the US state of Delaware, annual filings routinely omit information on directors and officers but the volume of returns received does not permit Delaware authorities to check and follow up except in the event of an investigation.<sup>10</sup> Delaware is attempting to improve compliance by introducing an Internet-based filing system, which would require all fields, including those pertaining to directors and officers, to be completed.

More specifically, some jurisdictions do not have sufficient resources devoted to facilitating the exchange of information. The lack of personnel devoted to these functions often results in considerable delays in the provision of information.

In some jurisdictions, the judicial system has limited capacity and is not able to, among other things, issue subpoenas, respond to requests for access to information, and resolve challenges to the use of compulsory powers in a timely manner. In addition, the appeal process in some jurisdictions is so cumbersome and protracted that it effectively denies authorities access to the requested information.

In addition, some jurisdictions limit the channels through which information may be shared. While this might be the standard procedure under certain legal systems, the ability to share information on a timely basis may be impeded when the channel through which information exchange must occur does not function well

(*e.g.*, considerable backlog of cases in the court system, insufficient staffing in the attorney general's office or the relevant regulatory body, etc.). Furthermore, certain authorities, particularly regulators/supervisors, may not have any access to information when the existing channels for information sharing are available only to criminal law enforcement authorities.

Even when strong compulsory powers and institutional capacity exist, the authorities in some jurisdictions have consistently shown a reluctance to fully employ their powers for regulatory/supervisory or law enforcement purposes or to assist other authorities domestically and internationally to fulfil their regulatory/supervisory or law enforcement responsibilities. In some jurisdictions, the authorities interpret information sharing provisions narrowly and limit the types of authorities with whom information may be shared.

### **3. *Intermediaries – company formation agents, trust companies, lawyers, notaries, trustees, and other professionals***

In most jurisdictions, intermediaries, such as company formation agents, trust companies, lawyers, notaries, trustees, and other professionals, play a role in the formation and management of corporate vehicles. Through performing these functions, intermediaries are often in a position to know the beneficial owners and controllers of corporate vehicles. Accordingly, intermediaries are a potentially valuable resource for authorities seeking information on the beneficial ownership and control of corporate vehicles.

In many jurisdictions, corporate service providers are likely to possess, or have access to, beneficial ownership and control information. In most OFCs and some onshore jurisdictions, corporate service providers typically perform all functions related to the incorporation and management of the corporate vehicle. Although many corporate service providers offer incorporation services for a variety of jurisdictions, they may not maintain a physical presence in all of these jurisdictions or may not maintain records in the jurisdiction where the corporate vehicle was established. Consequently, the authorities in a particular jurisdiction may encounter difficulties in obtaining information from intermediaries that do not maintain a physical presence or records in that jurisdiction.

In many civil law jurisdictions, notaries play a role in incorporating a company and in effecting subsequent transfers of shares. In Germany, for example, a notary drafts the incorporation documents of public and private limited companies and records subsequent changes in management. In addition, all transfers of shares in a private limited company must be notarised. Notaries are also responsible for maintaining notarised records and making such records available to those with a recognisable legal interest in them, including authorities. In some jurisdictions, notaries are also subject to customer identification requirements,<sup>11</sup> which

increases the likelihood that notaries will possess information on the beneficial ownership and control information of corporate vehicles.

Lawyers and accountants constitute another source of beneficial ownership and control information. In certain jurisdictions, only lawyers and accountants may incorporate companies. In jurisdictions that provide exemptions from customer identification requirements for clients referred by certain intermediaries, such as lawyers and accountants, the beneficial owners of corporate vehicles often act through such intermediaries.

Recognising the important role that intermediaries play in their jurisdictions, some OFCs are beginning to regulate such intermediaries and require them to maintain information on beneficial ownership and control and to make such information available to authorities for investigatory and regulatory purposes. Within the European Union, the European Commission has proposed extending client identification, record keeping, and suspicious transactions reporting requirements to, among others, notaries and lawyers carrying on financial or company law activities (including creating, operating, or managing companies, trusts, or similar structures and handling clients' money, securities, and other assets).

#### **4. How Information is Maintained and Accessed**

How information is maintained and how information can be accessed also contribute to the ability of authorities to obtain and share information on beneficial ownership and control.

In many jurisdictions, including those that require up front disclosure of beneficial ownership information, the regulatory regime requires periodic submission of company-related information to the authorities, such as shareholders lists and director information. As stated previously, the use of nominees may reduce the usefulness of such information for identifying beneficial owners. Nonetheless, authorities may wish to access this information to establish a lead that could eventually take them to the beneficial owners.

In all EU countries and many other jurisdictions, information maintained by the companies registry is available to the public. In certain jurisdictions, including Finland, Japan, Luxembourg, the Netherlands Antilles, Spain, Switzerland, and the United Kingdom, the companies registry is accessible via the Internet. The availability of information over the Internet facilitates information sharing because foreign authorities are able to access such information directly.

#### **5. Ability to Protect Information Shared**

The ability of the receiving party to protect information shared is an important consideration that impacts the ability and willingness of authorities to share

information. Such concern relates to both domestic and foreign authorities who receive confidential information. In many jurisdictions, the law permits the sharing of confidential information only when adequate assurance has been received that information shared will be protected from further disclosure. In Australia, information provided by the Australian Securities and Investments Commission (ASIC) to other domestic and foreign authorities can only be used for its stated purpose and consent of ASIC must be obtained if the information is to be released further.

Correspondingly, the domestic laws of many jurisdictions provide that information received from foreign authorities will be protected from further disclosure. In the United Kingdom, the Criminal Justice (International Co-operation) Act 1990 prohibits information received from abroad under letters rogatory (letters of request) to be further disclosed without the consent of the jurisdiction that provided the information.

In many cases, issues of confidentiality of information shared are addressed in formal bilateral agreements, such as mutual legal assistance treaties, tax treaties, or memoranda of understanding, as well as in multilateral instruments.

#### **6. Familiarity with laws and procedures and issues relating to trust and relationship building**

The laws of many jurisdictions permit the sharing of information through both formal and informal channels. However, effective co-operation (particularly with respect to a request for informal assistance) may be hampered by the lack of familiarity with foreign legal systems, laws, and procedures. In addition, co-operation may not materialise as envisioned due to the lack of a personal relationship and trust. Even though many jurisdictions are willing to offer *ad hoc* assistance to foreign authorities, co-operation may not be forthcoming because the authorities receiving the request do not know or do not trust the authorities who requested assistance.

Domestically, authorities have also undertaken initiatives to facilitate information sharing. In Jersey, for example, the Financial Services Commission has established a Financial Fraud Information Network to gather regulators, the police, and customs and enforcement officials periodically to promote co-operation between various local authorities and to develop a joint strategy for dealing with money laundering and other financial crimes. In the United Kingdom, a similar organisation is also in operation.

#### **7. The Role of the Internet**

The Internet can both facilitate and impede the ability of authorities to obtain information on beneficial ownership and control. On the one hand, the advent of the Internet may make it easier for individuals to hide their identity by enabling

them to establish corporate vehicles and to open bank accounts in various foreign jurisdictions without having to physically visit those jurisdictions. A quick search on the Internet will reveal a number of websites that offer on-line registration of corporate entities. This may make it more difficult for authorities and intermediaries to ascertain the identity of the beneficial owner.

On the other hand, the Internet, as a medium that disseminates information quickly, widely, and cheaply, can also be used to reduce anonymity and provide a way to trace communications. For example, the companies registries of Finland, Japan, Luxembourg, the Netherlands Antilles, Spain, Switzerland, and the United Kingdom are accessible over the Internet. In the Netherlands Antilles, the companies registry website is visited on average 30 000 times a week, even though there are only 32 000 companies registered in that jurisdiction.

#### D. Means to Obtain Beneficial Ownership and Control Information

A variety of *ex ante* and *ex post* mechanisms are used by domestic authorities to obtain information on the beneficial ownership and control of corporate vehicles. These mechanisms should be viewed in the context of the particular characteristics of a jurisdiction's economy and legal system. The following summarises the primary mechanisms available to the authorities to obtain beneficial ownership and control information of corporate vehicles established in their jurisdictions.<sup>12</sup>

- **Mandatory reporting** – In a small number of jurisdictions, the authorities require disclosure of beneficial ownership at the incorporation stage and when any subsequent transfers of beneficial ownership occur. Other forms of mandatory reporting, which may be made to the authorities and/or the corporate vehicle itself, include periodic submission of information (*e.g.* annual return, tax filings) and declaration of shareholdings upon reaching certain thresholds. Some of this information is made available to the public (*i.e.*, via a companies registry) while other information remains confidential.
- **Compulsion power** – power granted to regulatory and law enforcement authorities pursuant to statutory law enabling such authorities to compel testimony or access records/documents held by a regulated entity/licensee and, in some cases, any person possessing relevant information. In certain jurisdictions, the authorities may compel the production of client information required to be maintained under customer identification requirements.
- **Court-issued subpoena** – application to a court to require a person or entity named in a subpoena to give testimony or produce records and other documents. Some jurisdictions permit access to client information required to be maintained under customer identification requirements only through a court order.

## 1. Corporations

Most jurisdictions depend primarily on investigative means (through compulsion power, court-issued subpoenas, and other measures) to obtain information on beneficial ownership. A number of jurisdictions require extensive up front disclosure and updating of beneficial ownership and control information of corporations to the authorities. Some jurisdictions supplement the above approaches with a mechanism that imposes responsibility on corporate service providers and other third parties to obtain, verify, and retain records on beneficial ownership and control and to grant authorities access to such records for the purpose of investigating illicit activities, fulfilling their regulatory/supervisory functions, or sharing such information with other authorities domestically and internationally.

Although many jurisdictions require public disclosure of shareholders and directors, they do not require a declaration of beneficial ownership where this differs from nominal ownership and do not require shareholders that are corporate vehicles to declare their own beneficial ownership. Furthermore, the initial disclosure of information to the authorities regarding incorporators and founders may not identify the beneficial owners either because these functions are often performed by company formation agents and other professional service providers.

The following presents the types of mechanisms that authorities employ to obtain information on corporations established in their respective jurisdictions:

### a) *Ex ante mechanism – up front disclosure of beneficial ownership and control to the authorities*

A few jurisdictions, primarily OFCs, require the disclosure of beneficial ownership information of corporations to the authorities at the incorporation stage and, in most cases, such information must be updated when subsequent changes occur. Ordinarily, beneficial ownership information disclosed to the authorities is treated as confidential, although disclosure may be made under certain conditions.

The following presents, as examples, the up front disclosure system of two jurisdictions, Bermuda and Jersey (see boxes).

### b) *Ex ante mechanism – other mandatory reporting*

While only a few jurisdictions require up front disclosure of beneficial ownership and control information to the authorities at the incorporation stage, many jurisdictions (particularly in onshore jurisdictions) have instituted mandatory reporting requirements that obligate certain parties to furnish information to the authorities<sup>13</sup> or the company on a periodic basis or upon the occurrence of specified events.

In many jurisdictions, companies are required to provide shareholders lists and director information in their annual return filings. In some jurisdictions, changes of ownership must be disclosed to the authorities when they occur. However,

## Bermuda

Bermuda has required up front disclosure of beneficial ownership of exempt companies since the 1950s. An application for the incorporation of a local or exempted company is submitted to the Ministry of Finance through the Bermuda Monetary Authority (BMA). This application must include details of the beneficial owners who will hold more than five per cent of the share capital of the company. Each beneficial owner must sign a declaration attesting to his or her good standing generally. In the event that a company to be incorporated is to be owned by a corporate vehicle, the following information must be disclosed:

- *Company whose shares are not traded on a stock exchange* – the ultimate beneficial owner of such company.
- *Company whose shares are traded on a stock exchange* – latest annual report to shareholders (this is not required where the shares are listed on an “Appointed Stock Exchange”).
- *Trust* – name of the trust, date on which it was created, and the country in which it was created; full details (name, address, and nationality) of the settlor and beneficiaries (if any); and name and address of the trustee.
- *Partnership* – full details of the limited and general partners.

Based on the initial information provided, the BMA undertakes a vetting of the beneficial owners to assess whether to approve the application for registration. This is done through consulting commercial electronic databases, such as Lexis/Nexis and Dow Jones, and domestic and foreign authorities.

All subsequent transfers of beneficial ownership of a corporation require prior approval from the BMA. An exemption from this requirement is available for beneficial owners holding less than five per cent of the share capital of a company and in certain situations where frequent transfers of ownership are expected, such as for mutual fund companies and companies listed on an “acceptable stock exchange”.

In addition to the above, Bermuda requires the disclosure of beneficial ownership of all foreign-incorporated companies doing business in Bermuda.

Only lawyers and accountants are permitted to incorporate companies, and these professionals are not formally subject to customer identification requirements under anti-money laundering legislation.

Beneficial ownership information furnished to the BMA is held in strict confidence. A shareholder register must be maintained by each company (but nominees may be used) and must be kept at its registered office or at another place in Bermuda approved by the Registrar of Companies. The share register is open to public inspection. Bearer shares and corporate directors are not permitted.

As of March 2000, the Companies Registry contained 2 528 local companies and 10 771 active exempt companies. Of these, 169 local companies and 1 408 exempt companies were incorporated during the previous 12 months.

## Jersey

In Jersey, all companies (local, exempt, and IBCs) are required to disclose beneficial ownership information to the Jersey Financial Services Commission (FSC) at the time of incorporation. Pursuant to the Control of Borrowing (Jersey) Order 1958 (“COBO”), an application for the registration of a Jersey company must include information on the ultimate beneficial owner of the proposed company. When a company to be incorporated is to be owned by a corporation or trust, COBO requires the following disclosures:

- *Company whose shares are not traded on any stock exchange* – the ultimate beneficial owner of such company.
- *Company whose shares are traded on a recognised stock exchange* – latest annual report and accounts.
- *Company whose shares are traded on a non-recognised stock exchange* – latest annual report and accounts and details of any shareholders who own 10% or more of the shares of the company, or related shareholders (e.g., family members) who between them have a shareholding of 10% or more.
- *Trust* – names of the trustees, the name of the trust, and the name and address of the settlor, along with a confirmation that the corpus of the trust has been, or will be, provided solely by the settlor from his or her own resources.

As part of the incorporation process, the FSC undertakes a background check on the beneficial owner, investigating such matters as prior bankruptcies, criminal records, and prior investigations. In addition to requiring disclosure of beneficial ownership information, the FSC requires applicants to state with specificity the activities to be carried out by the soon-to-be incorporated company. The FSC then performs various tests, such as a fit and proper test, qualification test, and/or size and stature test, before deciding whether to approve the application.

The application for incorporation must be prepared and signed by a Jersey-licensed lawyer or accountant, who is under an independent obligation to know his customers.

Under COBO, the FSC may, and usually does, condition approval of an application for incorporation on 1) no change in intended activity and 2) no change of beneficial ownership without the prior approval of the FSC. In any event, any changes in beneficial ownership of an exempt company or an IBC must be notified to the FSC when it occurs. Local companies are not required to update the FSC regarding changes of beneficial ownership. Beneficial ownership information is also disclosed to the tax authorities at the time of incorporation and when subsequent changes occur.

Beneficial ownership information provided to the FSC is held in confidence and does not appear on the companies register. While a shareholders list must accompany each annual return, nominees may be used and consequently, the shareholders list may not necessarily reveal the identity of the beneficial owner. Information on directors must be reported to the Registrar, but this information is not open to the public. Bearer shares are not permitted.



**Jersey (cont.)**

Jersey plans to introduce legislation to require foreign-incorporated companies that are managed in Jersey to disclose beneficial ownership information to the FSC.

As of November 2000, the Jersey Companies Registry contained 33,000 “live” companies (*i.e.*, companies that are up to date on their annual return filings). Of these, approximately 19,000 are exempt companies, approximately 100 are IBCs, and the remaining 14,000 are taxpaying companies. Each year, Jersey FSC registers approximately 3,000 companies but the net increase is 400-500 companies per year as a number of companies voluntarily dissolve or are struck off the register for failure to file an annual return.

many jurisdictions permit the use of nominees in company documents, such as shareholders lists. Consequently, the information provided in shareholders lists may not contain the identity of the beneficial owners. Despite this shortcoming, shareholders lists provided to the authorities may enable them to establish a connection that could eventually lead to the beneficial owner.

Some jurisdictions have introduced safeguards to ensure that shareholders lists submitted to the authorities contain the identity of the beneficial owners. In the United Kingdom, the Companies Act requires a shareholder of a public company to notify the company when he acquires or disposes of any “interests” in the company’s voting shares at specified thresholds, starting at 3 per cent and in one per cent intervals thereafter. “Interests” cover not just legal ownership but beneficial ownership and the right to exercise votes attaching to shares.<sup>14</sup> Furthermore, a public company may issue a notice to anyone it reasonably believes to be interested in its shares (or to have been interested in the past three years), requiring them to confirm whether they have such an “interest”, and to provide other specified information, including information about anyone else he knows to have, or to have had, an interest in the company’s shares.

Where share registers are not required to be submitted to the authorities, companies are often required to maintain share registers, which domestic authorities are frequently able to access for regulatory/supervisory and law enforcement purposes. In some jurisdictions, the share registers must include information on beneficial ownership. In Portugal, where public limited companies (*sociedade anónima*) are not required to submit shareholders lists to the authorities, companies are required to record the identity and address of all bearer shareholders who

attend the company's annual general meeting. This information must be provided to the authorities upon request. In the Netherlands Antilles, beneficial ownership information of resident companies must be kept in the corporate books but is not required to be reported to the authorities, except when requested by them (through a court order) in the course of a criminal investigation.

In some jurisdictions, including many OECD Member countries, shareholders of public limited companies are required to report their holdings to the company when certain thresholds are reached. In Denmark, anyone who holds shares in a public limited company is required to notify the company once his interests reach five per cent or more of the voting rights of the company. Such shareholder must also report his interests at additional intervals of five per cent (*i.e.*, 10%, 15%, etc.). Ownership interest includes not only shares held by such person but also shares held in the name of any corporation that he or she controls. In addition, where a shareholder acquires all of the outstanding shares of a company, that shareholder is required to file a notice with the company. Conversely, when a shareholder who owns all of the outstanding shares of a company disposes of some or all of his shares, he is also required to notify the company. In Germany, all shareholders of a public limited company (AG) whose shares are not listed on a stock market are required to notify the company once their aggregate holdings exceed 25% of all outstanding shares.

Certain jurisdictions that permit the use of bearer shares have also imposed reporting requirements on bearer shareholders upon the occurrence of specified events. In some jurisdictions, including France, the Netherlands, and Spain, holders of bearer shares must disclose their identity to the company in order to exercise their voting rights and receive dividends.

c) *Ex ante mechanism – requiring third parties to maintain beneficial ownership and control information*

Various jurisdictions employ mechanisms that require third parties to maintain beneficial ownership and control information. In recent years, an increasing number of jurisdictions, particularly OFCs, have extended customer identification requirements under anti-money laundering legislation to intermediaries in order to ensure that beneficial ownership and control information is maintained by those involved in the formation and management of corporate vehicles. Financial institutions, for which the customer identification requirements were originally intended, have also been charged with identifying and retaining records relating to their clients. Lastly, in many civil law countries, notaries have traditionally served as a repository of information about corporate vehicles.

To prevent the misuse of corporate vehicles for illicit purposes, a number of OFCs, including the Bahamas, Cayman Islands, Isle of Man, Jersey, and the

Netherlands Antilles, have introduced, or have indicated that they will introduce, a system that requires intermediaries, such as company and trust service providers, lawyers, notaries, and trustees, to obtain, verify, and retain information on the beneficial ownership and control of the vehicles that they establish or manage and to grant authorities access to such information for the purpose of investigating illicit activities, fulfilling their regulatory/supervisory functions, or sharing such information with other authorities domestically and internationally.

While the general concept of requiring intermediaries to know their customers is similar, the particular mechanisms implemented or envisaged in each OFC is different. Consequently, the amount of information that is collected by intermediaries, and accessible to authorities, is also different. In Jersey, for example, the obligation to identify the beneficial ownership of corporate vehicles extends to a broad range of intermediaries, including company and partnership formation agents; companies furnishing directors, partners in a partnership, or nominee shareholders; companies providing a registered office; trustee of an express trust; and companies providing a registered office or business address for a company or partnership. In the Cayman Islands, the scope of entities subject to customer identification requirements is similar to Jersey except that, in the Cayman Islands, the Money Laundering Regulations 2000 do not apply to partnership formation agents and companies providing registered offices for limited or exempt limited partnerships.

In addition to the intermediaries described above, beneficial ownership and control information may also be available from financial institutions that are subject to customer identification requirements under anti-money laundering laws. In some jurisdictions with strict bank secrecy laws, however, the authorities may have limited access to such information.

Lastly, in many onshore civil law jurisdictions, notaries have the responsibility to maintain records of transactions in which they have been involved, such as the incorporation of a company and subsequent transfers of its shares. Notaries are also required to make such records available to those with a recognisable legal interest in them, such as authorities carrying out regulatory/supervisory and law enforcement functions. In some jurisdictions, notaries are subject to customer identification requirements, which increases the likelihood that they will also possess beneficial ownership and control information about corporate vehicles that were formed through them or whose transfers of shares were effected through them. Accordingly, the records retained by notaries may be useful to authorities that are seeking beneficial ownership information.

In all jurisdictions, the effectiveness of such mechanisms depends to a considerable extent on the ability of the authorities to ensure compliance with the applicable requirements and to impose sanctions in cases of non-compliance.

d) Ex post mechanism – investigation when illicit activity is suspected

Most jurisdictions, especially in the OECD area, rely primarily on investigative means, such as compulsion power, court-issued subpoenas, and other measures, to obtain beneficial ownership and control information when illicit activity is suspected.

In general, regulatory/supervisory and law enforcement authorities in many onshore jurisdictions possess strong powers that enable them, directly or indirectly (*e.g.*, through court-issued subpoenas), to require the disclosure of beneficial ownership and control information of corporate vehicles suspected of engaging in illegal conduct from individuals and entities that hold such information. In Australia, the Australian Securities and Investments Commission (ASIC) has the power to obtain beneficial ownership and control information under general provisions of the Australian Securities and Investments Commission Act 1989 (ASIC Act). In addition, Australian criminal investigative and other authorities have the power to obtain this information under general investigation and other powers conferred by statute. In Italy, authorities have unconditional access to non-public information regarding the beneficial ownership of corporate vehicles when investigating criminal offences. In other instances, such as to ensure compliance with existing laws (*e.g.*, tax assessment) or to prevent organised crime, access to such information is available but special rules apply. In Japan, investigating authorities, such as judicial police officers and public prosecutors, are empowered pursuant to statutory law to access company documents, including share registers, and to examine any person in order to investigate the beneficial owners and controllers of a corporate vehicle suspected of being misused for illicit purposes.

The laws of certain jurisdictions also enable the authorities to identify the beneficial owner when there is suspicion that the shareholder of record is a nominee. In Australia, the ASIC Act empowers ASIC to require a natural or legal person acquiring or disposing of shares, to disclose whether or not the person acquired or disposed of the shares as trustee for or on behalf of another person and, if so, to disclose the name of the person and any instructions in relation to the transaction.

In the United Kingdom, Section 442 of the Companies Act 1985 provides for the Secretary of State for Trade and Industry to appoint inspectors to investigate the membership of any company “for the purpose of determining the true persons who are or have been financially interested in the success or failure (real or apparent) of the company or able to control or materially to influence its policy”. Under Section 444, the Secretary of State can also investigate the ownership of shares in a company by requiring any person he has reasonable cause to believe may have, or be able to obtain, information as to the present and past interests in those shares (including beneficial ownership) to provide that information to him. These provisions also allow UK authorities or companies to pierce through

a shareholder that is a corporate vehicle in order to ascertain the latter's beneficial ownership.

In some jurisdictions, the capacity of authorities to obtain information is aided by other requirements and practices. In Spain, the ability of authorities to uncover the identity of beneficial owners is enhanced by the requirement that holders of bearer shares must be registered in order to exercise their voting rights and to receive dividends. In Portugal, a similar requirement is imposed on a bearer shareholder who wishes to attend the annual general meeting. Notwithstanding the possibility that a subsequent transfer of ownership may have occurred by the time the authorities access the information or that the person who presented the bearer shares was merely a nominee, the existence of a name in the share register provides a trail that may be useful to trace beneficial ownership.

Share registers that are maintained by companies are often open to the public. Where access to the share register is restricted, the authorities in most countries are able to access this information. In Denmark, all public authorities may inspect the share registers of Danish companies. In Spain, judicial authorities have access to the share registers of non-listed companies. In Switzerland, criminal prosecution authorities and fiscal authorities have direct access to the share registers of Swiss companies.

In FATF jurisdictions,<sup>15</sup> law enforcement, financial regulatory, and judicial authorities are generally able to access client identification data (which may include beneficial ownership information of accounts opened in the names of corporate vehicles) held by financial institutions. The means through which such information may be accessed depend on the type of powers granted to the relevant authority. In general, criminal law enforcement authorities require a search warrant or a subpoena to access client information. In contrast, financial regulatory authorities typically have direct access to client information, although in some cases only for supervisory purposes.

In most OECD Member countries, tax authorities are also able to access client information maintained by banks. In addition, all OECD Member countries allow access to client information maintained by banks for various non-tax related civil and criminal proceedings.

In jurisdictions with strict bank and corporate secrecy laws, access to beneficial ownership and control information is usually more limited.

## 2. Trusts

Given the private nature of trusts, most jurisdictions have consciously chosen not to introduce an extensive up front disclosure system for trusts. Consequently, the authorities in most jurisdictions rely on investigative mechanisms to obtain

beneficial ownership and control information. In a few jurisdictions, trusts are required to be registered with the authorities.

Where trusts hold shares in a corporation, certain jurisdictions require the disclosure of the trust settlor, beneficiaries, and/or trustees. As stated previously, an increasing number of jurisdictions are imposing customer identification requirements on trust service providers, including requirements to identify the settlors and beneficiaries of a trust, and the authorities in those jurisdictions rely on such intermediaries for information on the beneficial ownership and control of trusts. However, in some jurisdictions, the authorities may not have direct access to such information. In Bermuda, the Monetary Authority and Minister of Finance may access individual trust accounts maintained by trust companies only through a court order, which can be granted only if the information sought relates to drug trafficking, money laundering, theft of trust assets, or offences that contravene an international agreement binding on Bermuda. In contrast, regulators in the Cayman Islands and Jersey have the power to access individual client information maintained by trust companies, which are regulated entities under their respective regimes.

### **3. Foundations**

In many civil law jurisdictions, foundations are highly transparent and highly regulated corporate vehicles that are required to register with the authorities, file annual financial statements, and submit themselves to supervision by governmental authorities. In these jurisdictions, the authorities possess a considerable amount of information on these entities.

In Norway, for example, a foundation must be registered at the central registry and must be governed by a board of directors that is independent from the founder. In Denmark, a foundation that owns more than 50 per cent of the votes in a limited company or that engages in commercial activities (“commercial foundation”) is required to register at the Danish Commerce and Companies Agency (DCCA) and to submit annual reports, including financial statements, to the DCCA.<sup>16</sup> In addition, all foundations, commercial or private, must be managed by a board of directors that is independent from the founder and furthermore, the foundation may not distribute any grants to the founder. Lastly, Danish authorities are also able to require a commercial foundation to furnish a list of all persons who are receiving grants from the foundation. The authorities, however, are not able to require the disclosure of the identity of future grantees.

In other jurisdictions where foundations are not subject to rigorous supervision, authorities rely on investigative means to obtain beneficial ownership and control information about foundations.

#### 4. Partnerships

In general, partnerships do not appear to be misused to the same extent as other corporate vehicles. Compared to corporations, partnerships are less regulated and few jurisdictions maintain on-going supervision on partnerships, unless they are engaged in financial services and other regulated activities.

Limited partnerships and limited liability partnerships (LLPs) are required to be registered but there are usually no substantive on-going reporting requirements. With respect to limited partnerships, certain jurisdictions, such as Bermuda, most US states, Jersey, and the Netherlands Antilles, require only public disclosure of general partners while other jurisdictions, such as Germany and the United Kingdom, require public disclosure of limited and general partners.

A few jurisdictions require the disclosure of beneficial ownership for limited partnerships. In Cyprus, limited and international partnerships are required to register with the Register of Partnership and to disclose beneficial ownership information publicly. Where a corporation serves as a general partner of a Jersey limited partnership, the Jersey FSC requires disclosure of the corporation's beneficial owners. In addition, the Jersey FSC has the discretion to deny registration to limited partnerships as well as LLPs. A similar regime also exists in Bermuda.

Where information on the beneficial ownership and control of partnerships is not available through public filings, authorities typically employ investigative means to obtain such information. In a few jurisdictions, partnership formation agents and companies providing registered offices for partnerships are required, pursuant to anti-money laundering legislation, to maintain information on the beneficial ownership and control of partnerships.

#### E. Sharing Information on Beneficial Ownership and Control

The ability of authorities to obtain information on beneficial ownership and control must be accompanied by a corresponding capacity to share such information, on a timely basis, with other authorities domestically and internationally respecting each jurisdiction's own fundamental legal principles. Combating cross-border illicit activities requires effective co-operation among regulatory/supervisory and law enforcement authorities, including sharing information on the beneficial ownership and control of corporate vehicles suspected of engaging in illegal conduct. Within a jurisdiction, the sharing of information is necessary because certain authorities may maintain, or have better access to, information that is required by other domestic authorities for regulatory/supervisory and law enforcement purposes.

This section examines the mechanisms through which the exchange of information occurs and analyses the various facets of information sharing. These

include the nature and types of information to be exchanged, the proposed uses of information shared, and the types of authorities involved in information sharing. Most of these issues are addressed in the 1998 G-7 *Ten Key Principles on Information Sharing* and the 1999 G-7 *Ten Key Principles for the Improvement of International Cooperation Regarding Financial Crime and Regulatory Abuse* (together, the “G-7 Principles”).

### **1. The Basis for Information Sharing**

In most jurisdictions, statutory law provides the basis upon which authorities are empowered to share information domestically and internationally. In particular, domestic legislation and bilateral or multilateral agreements specify which authorities, and the extent to which such authorities, may co-operate with other authorities, including to share information. In addition, information sharing may occur pursuant to other rules, practices, and mechanisms governing international co-operation in judicial and administrative matters. The following examples illustrate the basis for information sharing in some jurisdictions:

In Australia, the Mutual Assistance in Criminal Matters Act 1987 provides the legislative basis for Australia to enter into arrangements with other countries for mutual assistance in criminal matters. Correspondingly, the Mutual Assistance in Business Regulation Act 1992 (MABRA) establishes a framework for Australian business regulatory agencies to provide assistance to their overseas counterparts “for purposes relating to the administration or enforcement of a foreign business law”. Such assistance includes using its compulsory power to obtain documents or compelling testimony on behalf of a foreign regulator. In addition, the ASIC Act gives the Australian Securities and Investments Commission discretion to share confidential information with other domestic authorities.

In Bermuda, the Criminal Justice (International Cooperation) (Bermuda) Act 1994 requires Bermuda to co-operate with foreign jurisdictions in any criminal proceedings and investigations. The Evidence Act 1905 and Supreme Court Rules 1985 enable foreign authorities (*e.g.*, through letters rogatory) to obtain evidence from Bermuda for use in civil or criminal proceedings in the requesting country. In addition, the 1988 tax information exchange agreement with the United States opened gateways to share information for tax purposes.

In Hong Kong, the Securities and Futures Commission (SFC) Ordinance provides for the sharing of information between the SFC and foreign regulators. The Mutual Legal Assistance Ordinance, which came into force on 20 February 1998, allows the Hong Kong government to assist foreign authorities in the investigation and prosecution of crime. The Ordinance provides for assistance in, among other things, compelling the production of documents and testimony. The Ordinance also provides for the entering into agreements with the governments of other



jurisdictions to facilitate co-operation in criminal matters. However, assistance may be rendered under this ordinance even in the absence of a formal agreement.

In Italy, Article 4 of the Legislative Decree No. 58 of 1998 requires CONSOB (*Commissione Nazionale per le Società e la Borsa*), the securities market regulator, and the Bank of Italy to co-operate with the competent authorities of member States of the European Union and permits these authorities to co-operate with the competent authorities of non-EU countries.

## 2. Channels for information sharing

The sharing of information on beneficial ownership and control is carried out primarily through four principal channels. These consist of mutual legal assistance treaties, letters rogatory, memoranda of understanding, and informal arrangements. The following provides a brief description of these channels and an analysis of their utility in facilitating timely information sharing:

- **Mutual legal assistance treaty (MLAT)** – A mutual legal assistance treaty (MLAT) is entered into by governments and allows for the exchange of evidence and other information in specified criminal matters.<sup>17</sup> In particular, MLATs provide for the power to summon witnesses, execute search warrants, serve process, and compel the production of documents and other physical evidence. Under an MLAT, each signatory designates a central authority through which requests for assistance are processed. The remedies offered by MLATs are generally available only to criminal law enforcement authorities and not to regulatory/supervisory authorities.

An MLAT provides a streamlined procedure for obtaining assistance and may remove the need for judicial authorisation, thereby reducing the time required to process a request. In practice, however, exchange of information under MLATs may be hampered by delays.

Because MLATs are individually negotiated, they can be structured to address specific issues (*i.e.*, provisions to overcome bank secrecy) that are of particular concern to both parties. The negotiation process also allows the authorities of both jurisdictions to gain in-depth knowledge of the legal and regulatory systems of the other country, which may expedite actual information sharing once the MLAT comes into force.

MLATs can be a useful instrument to overcome barriers erected by secrecy laws to limit access to banking and other records. In Anguilla, for example, bank secrecy provisions prohibiting disclosure of the identity of a depositor or customer without that person's consent or a court order do not apply to requests for assistance made under an MLAT.

- **Letter rogatory (letter of request)** – For matters outside of the scope of an MLAT, a letter rogatory may be used to request information from a foreign jurisdiction. A letter rogatory is a request from a judge in one jurisdiction to his counterparts in a foreign jurisdiction for assistance in obtaining records or in compelling testimony in the foreign jurisdiction. A judge in the requesting state may also issue letters rogatory on behalf of the police or prosecutors in his country. Virtually all jurisdictions recognise the concept of a letter rogatory.

In terms of efficiency, exchange of information through letters of rogatory may take months or years since some requests may have to be processed through diplomatic channels. When a letter rogatory must be routed through diplomatic channels, it typically follows the following path: court in home jurisdiction – Foreign Ministry of home jurisdiction – Foreign Ministry of foreign jurisdiction – Ministry of Justice or Attorney General's office of foreign jurisdiction – court in foreign jurisdiction. If the request is granted and information is provided, the same route is taken on the way back. In addition, there is also tremendous uncertainty as to whether co-operation will be forthcoming under a letter rogatory because various parties involved in the process (*e.g.*, foreign ministry, judge in the jurisdiction from information is sought) may unilaterally reject the request. In addition, the request may also be opposed by those from whom information is sought.

Some countries place limits on the use of letters rogatory to exchange information. In some jurisdictions, letters rogatory cannot be executed before formal criminal charges have been filed. Countries with strict bank secrecy laws sometimes prohibit the use of letters rogatory to obtain bank records.

- **Memorandum of understanding** – A memorandum of understanding (MOU) is an arrangement entered into between governmental agencies and forms the basis for co-operation between supervisors or law enforcement authorities domestically and internationally. An MOU expresses the intent of the parties to use their best efforts to provide assistance on specified matters and regulates how information will be exchanged. Information to be shared under an MOU could include information already in the possession of the authority, information that can be compelled by the authority, and information that can be obtained only through an investigation. In addition, MOUs contain safeguards protecting confidential information from being disclosed to third parties and limiting the use of information shared to designated purposes.

Information exchange carried out under an MOU usually does not require judicial intervention. While an MOU is not legally binding, agencies that enter into MOUs treat them very seriously. Frequently, an MOU is used to memorialise existing informal arrangements and understandings.

In essence, an MOU provides the mechanisms through which the authorities in one jurisdiction may obtain information on specified activities from their foreign

counterparts without having to resort to judicial measures. Accordingly, an MOU's effectiveness depends on the underlying statutory authority. In addition, with an MOU in place, regulators can avoid having to undertake individual negotiations each time information is requested. These features make MOUs an efficient mechanism to share information. Nonetheless, even when an MOU is in place, certain jurisdictions have experienced excessive delays in information sharing due to, among other things, a limited capacity of the relevant authorities to implement the MOU.

- **Informal arrangements** – In addition to the above mechanisms, certain authorities are able to pursue exchange of information domestically and internationally through informal channels. Informal channels may be an effective and efficient way to share information because procedural requirements are frequently minimised.

Informal arrangements, however, may not permit the sharing of confidential information. In addition, information shared on an informal basis may not be admissible as evidence in a court of law. Given these limits, authorities often follow up informal sharing with requests for information through more formal channels. Isle of Man authorities, for example, often exchange information on an informal basis as a precursor to more formal applications.

For informal channels to work effectively, authorities must be permitted under their domestic laws to obtain information on behalf of other domestic and foreign authorities and to share information in their possession without judicial intervention. This will often be the case where such authorities have already entered into MOUs or other arrangements that facilitate the provision of assistance outside of judicial channels.

Informal channels work best when the authorities responsible for facilitating information sharing are familiar with each other on a personal level. When personal relationship and trust exist, information may flow more readily.

### **3. Types of mechanisms used by jurisdictions to exchange information – general observations**

In most jurisdictions, the authorities are able to exchange information through formal and informal channels. The United States, for example, has entered into more than 50 MLATs, over 40 tax treaties, and several tax information exchange agreements. Its agencies, such as the Securities and Exchange Commission, are also parties to a multitude of MOUs and other arrangements. In some jurisdictions, information exchange occurs through only specified channels.

A few jurisdictions, such as the Niue and Samoa, have not entered into any formal agreements to exchange information even with respect to criminal matters.

In jurisdictions with strict secrecy laws, the channels through which information exchange may occur also vary. In the Bahamas, beneficial ownership information may only be exchanged pursuant to an MLAT or a letter rogatory.<sup>18</sup> Other secrecy jurisdictions permit the sharing of information only pursuant to MLATs. Since August 2000, Cayman Islands supervisors have been allowed to exchange information, including beneficial ownership information, without a formal agreement in place. Exchange of information through MLATs and letters rogatory is also available. However, the Cayman Islands financial intelligence unit is unable to share information with a number of its foreign counterparts.

#### 4. Facets of Information Sharing

The capacity of authorities to share information domestically and internationally depends on a number of factors, including whether the information to be shared falls into a generally restricted category, whether such information is confidential or non-confidential, whether such information is to be used for law enforcement or civil/regulatory purposes, and whether information is to be shared between authorities performing similar or non-similar functions.

##### a) Information falling into restricted categories

The exchange of information relating to tax matters and information held by banks is often restricted in some jurisdictions (including many OFCs), particularly those with strict secrecy laws or where tax evasion does not constitute a criminal offence.

In Gibraltar, the authorities maintain beneficial ownership information of exempt companies, which may be disclosed, through a court order, to foreign authorities for any civil or criminal proceeding. However, this mechanism is not available when the proceeding relates to the enforcement of foreign tax law. In the Isle of Man, the tax authorities are not empowered to collect information to assist their foreign counterparts. The Isle of Man, however, has recently committed to exchange information in civil and criminal tax matters as part of its commitment to curb harmful tax practices.<sup>19</sup>

Some jurisdictions have been generally unwilling to enter into agreements to share information relating to taxation. For example, the MLATs that the United States has entered with Anguilla and the Bahamas specifically exclude co-operation on fiscal offences.<sup>20</sup> However, assistance can usually be given for certain offences with a tax element (*e.g.*, taxpayer submits false income tax return with respect to unlawful proceeds of criminal activities). For example, the MLAT between Switzerland and the United States provides information sharing in cases of fiscal offences when the matter involved relates to organised crime.

Some OFCs have entered into agreements to exchange tax-related information. The Agreement Between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland (on behalf of Bermuda) for the Exchange of Information with Respect to Taxes contains provisions relating to mutual assistance in tax matters. In Jersey, the Comptroller of Income Tax may, pursuant to double taxation arrangements, disclose information relating to tax matters.

In addition, exchange of bank information is often restricted due to bank secrecy laws. In Cyprus, for example, secrecy rules prohibit the Central Bank to provide beneficial ownership and banking information to domestic tax authorities where an IBC uses nominee shareholders or where it is owned by a trust.

*b) Nature of information to be shared*

The nature of information also impacts the capacity of authorities to share such information. Information that is typically shared domestically and internationally, including beneficial ownership and control information, falls into the following categories: 1) publicly available information; 2) non-confidential and confidential information held by the authorities from whom assistance is sought; and 3) information held by third parties (including regulated entities) that can be obtained through compulsion or subpoena power.

In general, information that is publicly available may be freely shared. In some jurisdictions, beneficial ownership information of certain corporate vehicles may be found in publicly-accessible commercial registries. In certain jurisdictions, the companies registry is available over the Internet. In these cases, information sharing merely involves extracting the requested information and sending it in the form requested. If the authorities in the jurisdiction from which assistance is requested are unable to provide assistance, then the requesting authorities can usually obtain the requested information directly from the source.

Similarly, non-confidential information held by authorities in the jurisdiction from which assistance is requested may be freely shared unless domestic legislation prohibits assistance regarding the matter in question.

With respect to confidential information held by authorities, there are sometimes restrictions on its use, although domestic legislation usually provides gateways for sharing such information. In Jersey, beneficial ownership information disclosed to the Jersey Financial Services Commission is confidential. However, the Jersey Financial Services Commission (FSC) may, under certain circumstances, share this information with overseas regulatory authorities and law enforcement authorities in Jersey. Foreign law enforcement authorities may obtain this information by petitioning the Jersey Attorney General's office. In Switzerland, beneficial ownership information of public limited companies, which is not publicly available,

is accessible to, and may be shared among, domestic authorities involved in criminal or tax fraud investigations. Such information may be shared with foreign authorities in criminal proceedings under conditions of judicial assistance.

In some jurisdictions, the domestic legislation does not permit any authorities to share confidential information without the consent of the affected parties. In the Cook Islands, non-public information on corporate vehicles held by the authorities may be shared only if the directors, trustees, or partners (as applicable) have consented to the sharing of the information.

In many cases, confidential information originally received from a foreign authority may not be further disclosed domestically or internationally. For example, when the UK Serious Fraud Office obtains information from abroad under letters rogatory, it is unable to make further disclosure of that information without the consent of the jurisdiction that originally furnished that information. However, confidential information that becomes public record (*e.g.*, through disclosure in court) may generally be shared.

With respect to information that is not held by the authorities in the jurisdiction from which assistance is requested, the ease of access depends on which third party holds such information. In general, information that is publicly available, such as information in the companies registry, is freely exchangeable.

Where the information requested is held by a private third party, legislation may allow the domestic authorities to access such information and to share it with foreign authorities. In the Cayman Islands, the Monetary Authority Law enables CIMA to access individual client information from its licensees and to share such information with overseas regulatory authorities. In Hong Kong, the Securities and Futures Commission may use its wide powers of investigation to assist their foreign counterparts, including to compel information from third parties.

However, access to information held by a third party may not always be permitted under domestic law. As stated above, certain jurisdictions restrict access to information held by financial institutions.

*c) Information sharing for criminal versus civil/regulatory matters*

Whether information requested relates to a criminal or civil/regulatory matter also determines the type of information that is accessible to the authorities and the channels through which information exchange may be carried out. In general, more information can be obtained and shared when the information requested pertains to criminal offences rather than civil offences or regulatory matters.

Although most jurisdictions allow for the exchange of information for both criminal and civil/regulatory matters, certain jurisdictions, particularly OFCs, permit the sharing of information solely or primarily for criminal matters. In countries

with strict bank secrecy, secrecy protection is often lifted only in the event of a criminal investigation, thereby providing access to information to criminal law enforcement officials but not to regulatory authorities performing supervisory or enforcement functions.

In terms of channels through which information may be exchanged, MLATs and letters rogatory are generally used for criminal matters.

*d) Information sharing domestically and internationally and among authorities performing similar and different functions*

Whether information sharing is occurring domestically or internationally, or between authorities who perform similar roles or different roles, has a bearing on the availability of information for sharing. In general, information sharing among authorities falls into three categories:

- Information sharing between domestic authorities (*e.g.*, supervisor to law enforcement authority).
- Information sharing between domestic and international authorities performing similar functions (*e.g.*, supervisor to supervisor; law enforcement authorities to law enforcement authorities).
- Information sharing between domestic and international authorities performing non-similar functions (*e.g.*, supervisor to law enforcement authorities).

In certain situations, jurisdictions may impose restrictions on information sharing between domestic authorities. In Bermuda, for example, the police are required to obtain a court order before they are allowed access to beneficial ownership information held by the BMA.

In some jurisdictions, certain authorities are able to share information freely with various other domestic authorities. In the United Kingdom, the Serious Fraud Office is entitled to disclose information to other U.K. government departments, regulators, and various statutory, disciplinary or supervisory bodies for the purpose of assisting them in the performance of their functions or duties. Disclosure may also be made to the SFO's overseas counterparts for the same purpose. In addition, information may be disclosed by the SFO for the purpose of any prosecution domestically and internationally.

In Portugal, domestic regulatory authorities, such as the Comissão do Mercado de Valores Mobiliários (Portuguese Securities Market Commission), Bank of Portugal, and Portuguese Insurance Institute, may freely exchange confidential and non-confidential information for regulatory/supervisory purposes. These authorities can also enter into MOUs with foreign authorities performing similar functions – such as securities business regulatory authorities and banking and insurance authorities – in order to assist one another to carry out regulatory or

supervisory responsibilities. With respect to the exchange of information with foreign judicial and civil law enforcement authorities, co-operation must be handled through the homologous Portuguese judicial and civil law enforcement authorities, either directly or through the intermediation of the relevant domestic regulatory authority.

In many jurisdictions, domestic regulators are empowered to share information only with foreign regulators performing similar functions. Similarly, domestic criminal law enforcement authorities may only be allowed to co-operate with foreign criminal law enforcement authorities. In some jurisdictions, tax authorities are prohibited from co-operating with their foreign counterparts.

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## Notes

1. While many jurisdictions require the submission of shareholders lists and director information to the authorities, they do not require a declaration of beneficial ownership where this differs from nominal ownership and do not require shareholders that are corporate vehicles to disclose their beneficial ownership.
2. Some jurisdictions do not require books and records to be kept *at all*.
3. A few jurisdictions require the registration of trusts. In Labuan (Malaysia), for example, offshore trusts must be registered.
4. Trusts that engage in financial services activities, such as unit trusts that pool funds from the general public, are often regulated. In Japan, a civil law jurisdiction, the court supervises all private trusts except trusts engaged in commercial business.
5. Earlier this year, the European Commission submitted to the European Parliament a proposal to extend client identification, record keeping, and suspicious transactions reporting requirements to, among others, notaries and lawyers carrying on financial or company law activities (including creating, operating, or managing companies, trusts, or similar structures and handling clients' money, securities, and other assets).
6. In particular, FATF Recommendation 11 states that "financial institutions should take reasonable measures to obtain information about the true identity of the persons on whose behalf an account is opened or a transaction conducted if there are doubts as to whether these clients or customers are acting on their own behalf, for example, in the case of domiciliary companies" (*i.e.*, institutions, foundations, trusts, etc. that do not conduct any commercial or manufacturing business or any other form of commercial operation in the country where their registered office is located).  
In some jurisdictions, customer identification requirements constitute a part of a general obligation of financial institutions to know their customers. This obligation also includes, among other things, becoming familiar with a client's background and reviewing the client's actual transactions periodically to ensure that they are appropriate in relation to the client's background and business.
7. OECD Committee on Fiscal Affairs, *Improving Access to Bank Information for Tax Purposes*, 2000, p. 27.
8. INCSR 1999. See also 1998 UN Report, p. 31 (noting that certain agents can act as deputy registrars with the power to incorporate companies).
9. Including the Companies Investigation Branch (CIB) of the Department of Trade and Industry, Financial Services Authority, Serious Fraud Office, police, Crown Prosecution Service, the Bank of England, and the Stock Exchange.

10. In interviews conducted during a mission to the United States in November 2000, authorities in Delaware noted that the section on directors and officers in the annual return is frequently not completed but due to the volume of filings, checks and follow ups are not made except in the event of an investigation.
11. In Luxembourg, for example, the Money Laundering Act requires notaries to be aware of the identity of the actual beneficiary of each transaction.
12. Mechanisms employed to obtain beneficial ownership and control information from other domestic or international authorities will be examined in the section on the sharing of information.
13. Some civil law jurisdictions require the reporting of beneficial ownership information to professionals performing public functions, such as notaries.
14. The term "interests" also covers options and other derivatives conferring the right or obligation to acquire or dispose of voting shares. There are rules requiring the aggregation of family and corporate interests, and interests held by persons acting in concert.
15. The membership of FATF consists of Argentina, Australia, Austria, Belgium, Brazil, Canada, Denmark, European Commission, Finland, France, Germany, Greece, Gulf co-operation Council, Hong Kong China, Iceland, Ireland, Italy, Japan, Luxembourg, Mexico, the Kingdom of the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, Turkey, United Kingdom, and the United States.
16. Danish authorities are currently contemplating changing the ownership threshold to a lesser percentage because they are concerned that foundations that own less than 50% of a company may nonetheless exert a dominant influence over the company (particularly large companies with dispersed ownership).
17. In the tax area, exchange of information for tax purposes is generally carried out under the provisions of bilateral tax treaties, multilateral conventions for administrative assistance, and tax information exchange agreements.
18. However, during the year 2000, the Bahamas have adopted legislation that enables considerably, the exchange of beneficial ownership information.
19. Other jurisdictions making similar commitments include Bermuda, Cayman Islands, Cyprus, Malta, Mauritius, Netherlands Antilles, San Marino, and Seychelles.
20. However, in the case of the Bahamas, the Criminal Justice Act adopted in 2000 contemplates that co-operation for fiscal offences can happen in the context of a tax information exchange agreement.

## Part III

# Menu of Possible Options for Obtaining and Sharing Beneficial Ownership and Control Information

### A. Introduction

To successfully combat and prevent the misuse of corporate vehicles for illicit purposes, it is essential that all jurisdictions establish effective mechanisms that enable their authorities to obtain, on a timely basis, information on the beneficial ownership and control of corporate vehicles established in their own jurisdictions for the purpose of investigating illicit activities, fulfilling their regulatory/supervisory functions, and sharing such information with other authorities domestically and internationally. This requires adherence to three fundamental objectives (“Fundamental Objectives”), namely that 1) beneficial ownership and control information must be maintained or be obtainable by the authorities; 2) there must be proper oversight and high integrity of any system for maintaining or obtaining beneficial ownership and control information; and 3) non-public information on beneficial ownership and control must be able to be shared with other regulators/supervisors and law enforcement authorities, both domestically and internationally, for the purpose of investigating illicit activities and fulfilling their regulatory/supervisory functions respecting each jurisdiction’s own fundamental legal principles.

As part of the analysis of the Report, this Part presents a menu of possible options on the mechanisms available for obtaining information on the beneficial ownership and control of corporate vehicles. As stated earlier, this Report (and therefore these options) are applicable only to non-publicly traded/listed and non-financial services corporate vehicles. The options presented below, which are derived from the mechanisms existing in various jurisdictions, are grouped into three broad categories – 1) up front disclosure to the authorities; 2) requiring corporate service providers to maintain beneficial ownership and control information (“Intermediary Option”); and 3) primary reliance on an investigative system. Accordingly, provided that there is full adherence to the Fundamental Objectives discussed above, each jurisdiction may tailor and/or combine these options to fit

local conditions, legal systems, and practices. With respect to each option, a brief description and a summary of its primary advantages and disadvantages are provided. This is followed by an analysis of the principal factors that would make such option a suitable primary mechanism for obtaining beneficial ownership and control information in a particular jurisdiction, and the important elements of such option. Subsequently, this Part discusses countermeasures against instruments for achieving anonymity. Lastly, this Part refers to the 1998 G-7 *Ten Key Principles on Information Sharing* and the 1999 G-7 *Ten Key Principles for the Improvement of International Cooperation Regarding Financial Crime and Regulatory Abuse* (together, the “G-7 Principles”) as important in the context of domestic and international rules, practices, and mechanisms governing international co-operation.

In many jurisdictions, it may be possible to rely primarily on a particular option for one type of corporate vehicle while relying primarily on a different option for another type of corporate vehicle. For example, a jurisdiction may introduce an up front disclosure system for corporations while relying on an Intermediary Option or an investigative system for trusts. Similarly, a jurisdiction may distinguish among the various types of entities within a class of corporate vehicles (*e.g.*, private and public limited companies) and introduce an extensive, up front disclosure system only for entities that are most susceptible to misuse for illicit purposes.

The options presented here are, to a large degree, complementary. Depending on their particular circumstances, jurisdictions that rely primarily on one particular option may find it highly desirable and beneficial to supplement this mechanism with other options. For example, to prevent the misuse of corporate vehicles and to enhance the capacity of its authorities to obtain and share beneficial ownership and control information, a jurisdiction with a well-functioning investigative system may also choose to adopt an up front disclosure system or impose an obligation on corporate service providers to maintain beneficial ownership and control information. Likewise, a jurisdiction relying primarily on an up front disclosure system may also wish to require corporate service providers to maintain beneficial ownership and control information as a way to impose greater discipline on such providers and to create an additional repository of beneficial ownership and control information in the event that the information furnished up front to the authorities is incorrect or has not been updated. In such a situation, the jurisdiction in question may also find it desirable to strengthen its investigative mechanism by, for example, enhancing the powers of its authorities to access information held by corporate service providers. In fact, a strong investigative system is advantageous under all options because combating the misuse of corporate vehicles may require the use of investigative measures for such activities as seizing relevant evidence and interrogating witnesses.

Regardless of the option(s) adopted, there must be proper oversight and high integrity of any system for maintaining or obtaining beneficial ownership and control

information. In effect, each jurisdiction must ensure that there are credible sanctions that are sufficiently robust to deter misuses and to punish non-compliance and that these sanctions are vigorously enforced.

In addition, it is desirable that policymakers in each jurisdiction consider ways to make it possible to grant access to beneficial ownership and control information to agents with authority delegated by the government or the judiciary (such as insolvency administrators) and financial institutions seeking beneficial ownership and control information in order to comply with their customer identification obligations. As governments rely on financial institutions to be the first line of defence against the misuse of the financial system for illicit purposes, facilitating and removing obstacles to financial institutions' appropriate access to beneficial ownership and control information, where they exist, consistent with their customer identification obligations in their home jurisdictions could enable these institutions to better fulfil the duties that governments require them to assume.<sup>1</sup>

Lastly, it should be recognised that these options constitute only one means of combating and preventing the misuse of corporate vehicles for illicit purposes. In many jurisdictions, other measures to impose adequate controls in the way corporate vehicles function are also employed to prevent the misuse of corporate vehicles. These measures include mandating companies to maintain audited and published financial statements, requiring important decisions to be approved by at least two authorised personnel, and vetting directors for fitness. An in-depth examination of these measures, however, is beyond the scope of this Report.

## **B. Menu of Possible Options for Obtaining Beneficial Ownership and Control Information**

The mechanisms for obtaining beneficial ownership and control information fall into three broad categories: up front disclosure to the authorities; requiring corporate service providers to obtain, verify, and retain records on the beneficial ownership and control of corporate vehicles; and primary reliance on investigative measures when illicit activity is suspected. As stated above, provided that there is full adherence to the Fundamental Objectives, each jurisdiction may tailor and/or combine these options to fit its local conditions, legal system, and practices. The basic characteristics of these options are summarised below:

### **1. Option 1: Up front disclosure to the authorities**

**Description:** An up front disclosure system requires the disclosure of the beneficial ownership and control of corporate vehicles to the authorities at the establishment or incorporation stage and imposes an obligation to update such information on a timely basis when changes occur. The obligation to report beneficial ownership and control information to the authorities may be placed on the

corporate vehicle, the ultimate beneficial owner, or the corporate service provider involved in the establishment or management of the corporate vehicle. Jurisdictions may enhance the transparency of an up front disclosure system by choosing to make the beneficial ownership and control information collected available to the public at large.

**Primary advantages and disadvantages:** An up front disclosure system improves the transparency of corporate vehicles and ensures that certain authorities within a jurisdiction will, at all times, possess beneficial ownership and control information of corporate vehicles established in that jurisdiction. An up front disclosure system may also enhance the capacity of jurisdictions, especially but not exclusively those with limited resources and weak investigative powers, to co-operate more rapidly and more effectively with foreign authorities. In addition, an up front disclosure system, if effective, may have a strong deterrent effect because individuals seeking to obscure their identity through the use of corporate vehicles are likely to go to a different jurisdiction where anonymity can be more easily achieved. An up front disclosure system would also enable governments to make available beneficial ownership and control information to financial institutions (through various means such as a semi-public or public registry) in order to enhance the ability of these institutions to comply with their customer identification obligations, especially in the anti-money laundering context. However, in jurisdictions with a substantial domestic commercial sector, an extensive up front disclosure system may, under certain circumstances, impose significant costs on corporate vehicles (particularly smaller enterprises).

**Suitability:** Primary reliance on an up front disclosure system would be appropriate in jurisdictions with the following characteristics:

- **Weak investigative system** – an up front disclosure system may be the preferred option for obtaining beneficial ownership and control information in jurisdictions where the investigative system is generally weak (*e.g.*, authorities with weak compulsory powers, few resources devoted to regulation/supervision and law enforcement, and poorly functioning judicial and legal systems). Adopting an up front disclosure system, however, does not mean that a jurisdiction should not strive to improve its investigative system because combating the misuse of corporate vehicles for illicit purposes may require investigative measures such as seizure of relevant evidence and interrogation of witnesses.
- **High proportion of non-resident ownership of corporate vehicles** – jurisdictions in which a high proportion of the corporate vehicles are beneficially owned and controlled by non-residents may find it more appropriate to adopt an up front disclosure system because the authorities in these jurisdictions may face greater difficulties in ascertaining the beneficial ownership and

control of corporate vehicles. Of particular concern are corporate vehicles that are beneficially owned by non-resident individuals or by shell corporations rather than by foreign operating companies or companies whose shares are publicly traded. Similarly, an up front disclosure system may be appropriate for jurisdictions in which a high proportion of corporate vehicles consist of vehicles that are specifically designed for non-residents, such as IBCs, exempt companies, and offshore trusts.

- **High proportion of shell companies or asset holding companies** – where a high percentage of corporate vehicles within a jurisdiction are shell companies or are established to hold assets rather than to operate businesses requiring physical premises in the jurisdiction of establishment, it may be more appropriate for such a jurisdiction to employ an up front disclosure system as it may be more difficult for the authorities to locate persons connected to such vehicles, particularly the beneficial owners.
- **Availability of anonymity enhancing instruments** – in general, the greater the ability of an individual to effectively conceal his identity from the authorities through the use of anonymity instruments,<sup>2</sup> the greater the need for an up front disclosure system. Even if the authorities are eventually able to identify the beneficial owners and controllers, requiring the authorities to peel through various intermediary layers may result in considerable delays and additional expenses being incurred.
- **Important elements:** The organising principle of an up front disclosure system is transparency of beneficial ownership at every stage of a vehicle's life cycle. Under this system, the following elements are important:
  - **Important transparency elements at the establishment stage:**
    - a) **Corporation** – disclosure of the identity of the ultimate beneficial owner who is a natural person. Where shares are held by a non-publicly traded corporation, the identity of the ultimate beneficial owner of such company.<sup>3</sup> Where shares are held by a trust or foundation, the identities of individuals who furnished funds into the trust/foundation, beneficiaries (current and potential), trustee/members of the board, and protectors. Where shares are held by a partnership, details of the limited and general partners, including their beneficial owners. With respect to directors, disclosure of the identity of all directors, any “shadow” directors, and the ultimate beneficial owners of all “corporate” directors.
    - b) **Trust** – disclosure of the identity of the individuals who furnished funds into the trust, the beneficiaries (current and potential), trustees, and protectors; submission of a copy of the trust deed and all letters of wishes.

- c) **Foundation** – disclosure of the identity of the individuals who furnished funds into the foundation, the beneficiaries (current and potential), and members of the board; submission of a copy of the statutes/articles of the foundation.
  - d) **Partnership** – disclosure of the identity of the general partners and limited partners, if any. Where a partner is a corporate vehicle, the identity of the ultimate beneficial owner of such vehicle.
- **Important transparency elements regarding subsequent disclosures:**
    - a) **Updating information on a timely basis** – the disclosures made at the establishment stage should be updated on a timely basis upon any subsequent changes.
    - b) **Annual declaration** – in addition to the requirement to update changes in beneficial ownership and control on a timely basis, a jurisdiction may also choose to require corporate vehicles to submit an annual declaration listing any changes in their beneficial ownership and control or confirming that no changes occurred during the year in question.
    - c) **Mandatory reporting of beneficial ownership and control to the company** – to enhance a company's capacity to comply with reporting obligations under an up front disclosure system, a jurisdiction may choose to require the beneficial owners to notify the company of their shareholdings upon attaining a certain level of control (*e.g.*, five per cent of voting rights) and at specified intervals thereafter (*e.g.*, 10%, 15%, 20%, etc.). As a complementary measure, a jurisdiction may choose to give its corporations the power to inquire into the beneficial ownership of their own shares.
  - **Institutional features under an up front disclosure system:**
    - a) **Personnel and other resources** – while a jurisdiction adopting an up front disclosure system may not have a strong general investigative system, its authorities should have sufficient personnel and other resources to effectively administer an up front disclosure system [manage the information collected, verify information furnished and conduct any necessary follow up, and ensure ongoing compliance with applicable requirements (*i.e.*, obligation to update beneficial ownership and control information upon any subsequent changes)].
    - b) **Information technology** – a jurisdiction adopting an up front disclosure system should have adequate information technology systems that enable the relevant authorities to effectively and efficiently manage the information collected and to enable rapid and flexible search and retrieval of information.



- **Sanctions for non-compliance** – to be effective, it is important that the authorities are able to – and do – impose sanctions on corporate vehicles that do not comply with the applicable requirements under an up front disclosure system. Such sanctions should be substantial enough to deter the behaviour they are addressing and may include, among other things, promptly striking a company off the register, imposing a substantial fine, suspending control rights of beneficial owners, and revoking the right to conduct business.
- **Confidentiality of beneficial ownership and control information** – beneficial ownership and control information disclosed to the authorities may be treated as confidential or non-confidential (*i.e.*, maintained in the jurisdiction's companies registry and made available to the public). If protecting legitimate privacy interests requires such information to be treated as confidential, effective mechanisms must be developed for sharing such information with regulatory/supervisory and law enforcement authorities domestically and internationally respecting each jurisdiction's own fundamental legal principles.  
In addition, it is desirable that the authorities consider ways to make it possible to grant access to such information to agents with authority delegated by the government or judicial authority (such as insolvency administrators) and financial institutions seeking beneficial ownership and control information in order to comply with their customer identification obligations, provided that the recipient provides assurance that the information shared will not be further disclosed and will be used only for its stated purpose.
- **Disclosures for existing corporate vehicles** – beneficial ownership and control information of existing corporate vehicles should be ascertained and recorded within a pre-determined transition period and/or a jurisdiction may adopt a risk-based approach that requires beneficial ownership and control information to be ascertained and recorded only for those corporate vehicles that pose the highest risk of misuse for illicit purposes.

## 2. **Option 2: Imposing an obligation on corporate service providers to maintain beneficial ownership information (“Intermediary Option”)**

**Description:** The Intermediary Option requires intermediaries involved in the establishment and management of corporate vehicles, such as company formation agents, trust companies, registered agents, lawyers, notaries, trustees, and companies supplying nominee shareholders, directors, and officers (“corporate service providers”), to obtain, verify, and retain records on the beneficial ownership and control of the corporate vehicles that they establish, administer, or for which they provide fiduciary services.<sup>4</sup>

**Primary advantages and disadvantages:** The Intermediary Option may allow jurisdictions with limited financial and human resources to ensure that beneficial ownership and control information is available within their jurisdictions without having to adopt a full-fledged up front disclosure system. In addition to the up front disclosure option, the Intermediary Option may be particularly appropriate for jurisdictions where persons connected to the corporate vehicle are typically not located within the jurisdiction of establishment and where the corporate service provider serves as the primary link to such corporate vehicles. Provided that corporate service providers are able to – and do – maintain the requisite information on corporate vehicles and the domestic authorities have the capacity to – and do – ensure compliance with the applicable requirements, an Intermediary Option may also strike an appropriate balance between furthering the public's interest in combating the misuse of corporate vehicles and protecting legitimate privacy interests. Under certain circumstances, this mechanism may also have a preventive effect. Nonetheless, by requiring the authorities to obtain beneficial ownership and control information from third parties, the Intermediary Option introduces the potential for delays in the provision of information.

**Suitability:** Primary reliance on an Intermediary Option would be appropriate in jurisdictions with the following characteristics:

- **Adequate investigative mechanism** – the authorities in jurisdictions adopting this option must have adequate compulsory powers and institutional capacity to effectively monitor compliance by corporate service providers with their obligation to obtain beneficial ownership and control information. To enable the sharing of information on a timely basis, the jurisdiction concerned will have to devise efficient and rapid mechanisms for exchanging information at the domestic and international levels, since the requested authorities must first gather the information from the relevant intermediary before transmitting it to the requesting authority.
- **Pool of corporate service providers with suitable experience and sufficient resources** – given that beneficial ownership and control information will be maintained by third parties under the Intermediary Option, it is important that only corporate service providers possessing suitable experience/qualifications and sufficient resources be entrusted with this function. For this option to be effective, a jurisdiction should have a sufficient number of such corporate service providers and these providers should administer a large proportion of the corporate vehicles established in that jurisdiction.

**Important elements:** Under the Intermediary Option, the following elements are important:

- **Important transparency elements to be collected and maintained by corporate service providers** – the same type of information as for up front disclosure to the

authorities [see paragraph 250a-d (under Important transparency elements at the establishment stage)].

- **Regulatory and licensing regime** – for this option to be effective, it may be necessary to introduce a regulatory and licensing regime for corporate service providers and to permit only regulated or licensed corporate service providers to establish corporate vehicles or to offer fiduciary services. Such a regime could ensure that only those with suitable qualifications and experience are permitted to undertake corporate vehicle formation and management activities. In addition, such a regime would enable the authorities to establish appropriate standards on identification procedures, record retention, and monitoring of client transactions. Equally important, introducing a regulatory and licensing regime would permit the authorities to perform inspections to ensure compliance with the relevant rules and regulations.
- **Sanctions for non-compliance** – to be effective, it is essential that sanctions are imposed on corporate service providers and where appropriate, on corporate vehicles, that do not comply with the applicable requirements. Such sanctions may include, among other things, revoking a corporate service provider's licence or imposing a substantial fine.
- **Location of information and access by authorities** – to the extent possible, corporate service providers should be required to maintain records in the corporate vehicle's jurisdiction of establishment. Regardless of the location where beneficial ownership and control information is held by the corporate service provider, the authorities in the jurisdiction of establishment must be provided access to such information for regulatory/supervisory, law enforcement, and sharing purposes and without regard to whether a corporate service provider is regulated/supervised by the authority seeking the information.
- **Disclosures for existing corporate vehicles** – beneficial ownership and control information of existing corporate vehicles should be ascertained and recorded within a predetermined transition period and/or a jurisdiction may adopt a risk-based approach that requires beneficial ownership and control information to be ascertained and recorded only for those corporate vehicles that pose the highest risk of misuse for illicit purposes.

### 3. Option 3: Primary Reliance on an Investigative Mechanism

**Description:** Under an investigative system, the authorities seek to obtain (through compulsory powers, court-issued subpoenas, and other measures) beneficial ownership and control information when illicit activity is suspected, when such information is required by authorities to fulfil their regulatory/supervisory functions, or when such information is requested by other authorities domestically and internationally for regulatory/supervisory or law enforcement purposes.

**Primary advantages and disadvantages:** For jurisdictions that have already developed an effective and efficient investigative mechanism, continued primary reliance on this mechanism may be more cost effective than to establish and maintain an extensive, up front disclosure system. Moreover, in jurisdictions where a substantial domestic commercial sector exists, primary reliance on an investigative mechanism may, under certain circumstances, avoid unnecessary costs or burdens on corporate vehicles (particularly smaller enterprises), which may stifle legitimate business formation. An investigative mechanism, if effective, may also enable policymakers to maintain a reasonable balance between ensuring proper monitoring/regulation of corporate vehicles and protecting legitimate privacy interests. An investigative system, however, requires the authorities to obtain beneficial ownership and control information from third parties, thereby introducing the potential for delays in the provision of information.

**Suitability:** Primary reliance on an investigative mechanism would be appropriate in jurisdictions with the following characteristics:

- **Authorities with strong compulsory powers and the capacity to obtain beneficial ownership and control information** – primary reliance on an investigative system may be appropriate in jurisdictions where regulatory/supervisory and law enforcement authorities possess strong compulsory powers and have the capacity to obtain beneficial ownership and control information for regulatory/supervisory, law enforcement, or sharing purposes. To enable the sharing of information on a timely basis, the jurisdiction concerned will have to devise efficient and rapid mechanisms for exchanging information at the domestic and international levels, since the requested authorities must first gather the information from a third party before transmitting it to the requesting authority.
- **Reliable history of enforcement** – primary reliance on an investigative mechanism may be more appropriate where the authorities in a jurisdiction have, on prior occasions, consistently displayed a commitment to employ their compulsion powers for regulatory/supervisory or law enforcement purposes or to assist other domestic and foreign authorities to fulfil their regulatory/supervisory or law enforcement responsibilities.
- **Judicial system functions effectively and efficiently** – an effective investigative mechanism requires a well-functioning judicial system of high competence and integrity that is able to process subpoena or other order applications and to respond to requests for information in a timely manner.
- **Beneficial ownership and control information is likely to be available within the jurisdiction** – the effectiveness of an investigative system depends, to a significant extent, on the likelihood that beneficial ownership and control information of the type mentioned on pages 79-80 (under *Important transparency*

*elements at the establishment stage*) is available within the jurisdiction in which the corporate vehicles were established. Consequently, primary reliance on an investigative system would be more appropriate in jurisdictions in which a large proportion of corporate vehicles are beneficially owned and controlled by residents or which conduct operating businesses requiring physical premises in the jurisdiction of establishment and where persons are not able to effectively conceal their identity from authorities through the use of anonymity instruments.

**Important elements:** An investigative system is a general mechanism that relies on the general features of the legal system rather than on custom-made mechanisms to obtain beneficial ownership and control information. Accordingly, many of the suitability elements mentioned above also constitute important elements, of which the following are particularly relevant:

- **Institutional features under an investigative mechanism:**
  - a) **Adequately-staffed and well-funded regulatory/supervisory and law enforcement authorities** – for an investigative system to be effective, sufficient financial and human resources must be allocated to the relevant authorities to enable them to undertake effective monitoring and to investigate any illicit activity. In addition, adequate resources should be devoted to maintaining and enhancing the skill and expertise of the staff.
  - b) **Authorities with strong compulsory powers** – the regulatory/supervisory and law enforcement authorities within a jurisdiction must be granted powers that would enable them to obtain, on a timely basis, beneficial ownership and control information from any physical or legal persons possessing relevant information for the purpose of investigating illicit activities, fulfilling regulatory/supervisory functions, and sharing such information with other authorities domestically and internationally. With respect to such relevant information, efforts should be directed towards rapid access. In certain jurisdictions, rapid access may only be attainable if the relevant authorities are able to access such information without having to first obtain a court order. In addition, compulsory power may include an explicit power to inquire into the beneficial ownership and control of corporate vehicles.
  - c) **A strong, predictable, and efficient judicial system** – an investigative system requires a well-functioning judicial system of high competence and integrity to, among other things, issue subpoenas and other orders, respond to requests for information, and resolve challenges to the use of compulsory powers in a timely manner. Primary reliance on an investigative system requires that the legal system allow courts to act rapidly and decisively when the situation arises.

- **Maintenance of beneficial ownership and control information by companies** – to enhance the capacity of authorities to obtain beneficial ownership and control information, a jurisdiction may choose to require companies to maintain such information. A jurisdiction may also choose to give its corporations the power to inquire into the beneficial ownership of their own shares.

### C. Countermeasures Against Instruments for Achieving Anonymity

Individuals and corporate vehicles have legitimate expectations of privacy and business confidentiality in their affairs and jurisdictions adopt different approaches to protect legitimate privacy interests. Certain arrangements and practices can contribute to the potential for misusing corporate vehicles by making it very difficult, and perhaps even impossible, for the authorities to identify the beneficial owners and controllers. Jurisdictions should carefully consider whether the benefits of such practices outweigh the costs or whether they should be permitted, if at all, only under special conditions and in limited circumstances. The following instruments are examples of mechanisms that can be used to facilitate the misuse of corporate vehicles and they have also been identified as raising particular concern for money laundering purposes:

- **Bearer shares** – in certain jurisdictions, bearer shares are commonly and legitimately used. However, the high level of anonymity that they provide makes them attractive for nefarious purposes, especially in certain jurisdictions and in certain commercial contexts, such as shell companies and IBCs. In order to curb their misuse, jurisdictions may wish to review the use of bearer shares. Options might include their abolition or the introduction of measures to ensure 1) their immobilisation (*e.g.*, by requiring deposit of bearer shares with the authorities/licensed corporate service providers or by dematerialising shares) or 2) that their owners are known to the company or the authorities (*e.g.*, mandatory reporting of identity of bearer shareholder as a condition to exercise voting rights or to receive dividends or upon attaining certain levels of control).
- **Nominees** – nominees are commonly used for the clearance and settlement of trades in listed companies. However, their use in non-listed public limited companies and other corporate vehicles may lead to abuse. In jurisdictions where a high proportion of corporate vehicles are owned by non-residents or were formed to hold assets rather than to operate businesses requiring physical premises in the jurisdiction of establishment, policymakers may choose to permit only licensed corporate service providers to serve as nominees or fiduciaries. This would protect the legitimate privacy interest of the beneficial owner while providing increased assurance that the authorities will be able to discover the identity of the beneficial owners in appropriate circumstances.

- **“Corporate” directors** – directorships by legal persons lessen the accountability of directors by compromising the function of a board of directors as a means to impose responsibility on physical persons for the actions of a corporation. Jurisdictions should carefully review their legislation to ensure that individuals are not able to escape responsibility and accountability through the use of corporate directors.
- **Flee clauses** – any flee clauses that require a trust and information about a trust to be moved to a different jurisdiction upon receipt of service of process or inquiry by the authorities only serve to encourage and protect illicit behaviour. Jurisdictions should consider reviewing the use of flee clauses to evade service of process or inquiry by the authorities with a view to either abolish them or severely limit their availability.
- **Strict secrecy laws** – legal provisions that impose civil or criminal penalties on those who respond to legitimate requests for information by supervisory/regulatory and law enforcement authorities primarily serve as a shield to perpetrators of illicit behaviour. Jurisdictions should review the use of strict secrecy laws to ensure that effective gateways exist for obtaining beneficial ownership and control information and for sharing this information with other authorities in appropriate circumstances.
- **Trust laws** – trust law provisions and other arrangements that allow trusts to be established to delay, hinder, or defraud creditors only serve to encourage illicit activities. Similarly, trusts law provisions and other arrangements that permit the trustee to change or name new beneficiaries in a non-transparent manner encourage the use of trusts for illicit purposes. Jurisdictions should review the relevant features of the regulatory framework for trusts with a view to limiting the scope for misusing trusts for illicit purposes.

#### **D. Sharing Beneficial Ownership and Control Information Domestically and Internationally**

To effectively combat and prevent the misuse of corporate vehicles for illicit purposes, it is essential that the authorities in each jurisdiction have the capacity to share information on the beneficial ownership and control of corporate vehicles with other authorities domestically and internationally respecting each jurisdiction's own fundamental legal principles. The ability to share information among domestic authorities is important because certain authorities in a jurisdiction may possess, or have better access to, beneficial ownership and control information that are required by other domestic authorities for supervisory or law enforcement purposes. The availability of mechanisms to share information domestically also facilitates the efficient use of scarce resources by ensuring that duplicate efforts to obtain beneficial ownership and control information are not undertaken. In addi-

tion, because anonymity can be enhanced through the use of corporate vehicles incorporated in foreign jurisdictions, it is equally critical that the authorities in one jurisdiction also have the ability to share information on beneficial ownership and control with authorities in other jurisdictions.

In recent years, the G-7 Finance Ministers have undertaken substantial work to enhance international co-operation and information sharing. The 1998 *G-7 Ten Key Principles on Information Sharing* (see Annex II) and the 1999 *G-7 Ten Key Principles for the Improvement of International Cooperation Regarding Financial Crime and Regulatory Abuse* (see Annex II), in particular, address the most significant issues relating to sharing information on beneficial ownership and control of corporate vehicles among regulators/supervisors and law enforcement authorities.

Last viewed on 03/21/2017



## Notes

1. Many jurisdictions have in place strong anti-money laundering regimes that impose ultimate responsibility on financial institutions to know the beneficial owners and controllers of their corporate clients.
2. These anonymity instruments include bearer shares, nominee shareholders, nominee directors, "corporate" directors, intermediaries, letters of wishes, and flee clauses.
3. Where the shares are held by a publicly traded corporation, it may not be practicable to provide beneficial ownership information of such corporation since such information is subject to frequent changes. A jurisdiction may therefore exempt such corporation from having to furnish beneficial ownership information or may require only the disclosure of its major shareholders (*e.g.*, greater than 5% of the voting rights). In addition, a jurisdiction may choose to exempt only corporations whose shares are traded on established and reputable stock exchanges from having to disclose their beneficial ownership.
4. This may be achieved by, for example, extending customer identification requirements under anti-money laundering laws to corporate service providers.

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*Annex I*  
**Case Studies**

**I. Case studies on money laundering**

The following case studies provide examples on how corporate vehicles are used to launder money.

**Use of Loan Back Scheme in Money Laundering**

A Dutch criminal produced a quantity of the drug XTC and transported it to the United Kingdom to be sold. The proceeds amounted to around a million pounds sterling in the form of low value bank notes. Given the obligation on British banks to report suspicious transactions, the money was smuggled out of the United Kingdom to the Netherlands by the same route that had been used to bring the drug XTC into the country. Such a large amount of British pounds would have attracted attention in the Netherlands, and if deposited in a Dutch bank would have led to disclosure of the “unusual transaction”. For this reason, the money was smuggled to another country in which there was no or hardly any obligation to disclose transactions (a secrecy haven). The money was first taken to a former East European country, where it was exchanged for US dollars, which were paid into the account of a local enterprise with bearer shares bought from an intermediary. A false invoice (mentioning a management fee) was used to wire the money to the account of an offshore Caribbean investment company located in the Netherlands Antilles. The bearer shares of this offshore company were held by an offshore company in Panama, and the bearer shares of the latter company were held by a local attorney at law.

In the meantime, the Dutch criminal had set up a limited company in the Netherlands called Real Estate Investment, of which he was the manager and the only shareholder. The purpose of the company was to acquire money with which to buy and manage real estate. The criminal contacted the Caribbean investment company, from which his other company (Real Estate Investment) borrowed a sum of money amounting to around one million British pounds. Using this money, Real Estate Investment bought a large office building including a house. As the manager of the company, the criminal now manages the office building, lives in the house and drives an expensive company car. The office-building is rented out to businesses, and out of the money paid for the offices the manager draws a huge salary; the rest of the money is used to pay off the loan (the interest on which qualifies for tax deduction). Of course, the criminal is loaning his own (illegal) money and is the beneficial owner of the Caribbean investment company.

*Source: Euroshore Report, p. 90*

### **The Role of Offshore Shell Corporations and Secretarial Companies in the Laundering of Money**

During 1995/1996, financial institutions in a certain European country made a number of suspicious transaction reports to its financial intelligence unit. These reports identified large cash deposits made to banks which were then exchanged for bank drafts made payable to a shell corporation based and operated from an Asian jurisdiction. The reports alleged that approximately US\$1.6 million were being transferred in this manner. The police were simultaneously investigating a group in the country involved in the importing of drugs, and in 1997 managed to arrest several persons in the group, including the principal, who controlled the company located in the Asian jurisdiction. These persons were charged with conspiring to import a large amount of cannabis. A financial investigation revealed that the principal had made sizeable profits, a large percentage of which were traced. A total of approximately US\$2 million had been sent from the European country to the Asian jurisdiction, and subsequently transferred back to bank accounts in Europe, where it is now restrained.

Two methods were used to launder the money. The principal set up a shell company in the Asian jurisdiction which was operated there by a company providing secretarial and administrative services ("secretarial company") on his instructions. The shell company opened a bank account which was used to receive cashiers orders and bank drafts purchased for cash in the country of origin. The principal was also assisted by another person who controlled (through the same secretarial company) several companies. These companies were operated for both legitimate purposes and otherwise. The accomplice laundered part of the proceeds by sending the funds on to several other jurisdictions, using non-face to face banking (computer instructions from the original country) to do so.

Source: 1997-1998 FATF Report on Money Laundering Typologies.

## **II. Case studies on bribery/corruption**

The following case studies illustrate the role of corporate vehicles in bribery/corruption transactions.

### **Abacha Case**

The late Nigerian military dictator General Sani Abacha was alleged to have stolen US\$4.3 billion during his five years in office. Some of that money was funnelled out of Nigeria through Abacha's sons and business associates, who deposited the money in the names of front companies, including those established by Citibank. Approximately US\$1 billion was stolen through awarding contracts to front companies.

Source: *Guardian*, *British Banks Set to Freeze Dictator's Millions*, David Pallister and Peter Capella (8 July 2000); Sue Hawley, *Exporting Corruption: Privatisation, Multinationals and Bribery*.

### Russo Cable Case (Guardian Bank and Trust case)

The Russo Cable case involved the use of an offshore company and bank account to facilitate bribery. Frank Russo owned and operated a Florida corporation called Leasing Ventures, which sold illegal cable TV converter boxes and descramblers that enabled purchasers to access pay-per-view channels without having to make payments to their local cable TV providers. Russo wanted to secure a steady supply of cable boxes and descramblers since there was brisk demand for these devices. Up to that point, Russo had obtained the cable boxes through robbery and by raiding trucks and warehouses. Russo approached two employees of General Instrument, a leading cable converter box producer, and offered to pay them bribes if they agreed to supply him with cable converter boxes. The two employees, alarmed that they may have met a gangster, reported the incident to the Federal Bureau of Investigation (FBI). The FBI, which was itself investigating pirated cable converter boxes and had even established a cable converter box company called Prime Electronics and Security, Inc. in the attempt to bait cable pirates, told one of the employees to strike a deal with Russo.

Once a deal was struck, Russo began to pay the General Instrument employee bribes of US\$10,000 per month. Initially, payments were made in cash. Russo then came up with the idea of using an offshore shell company in the Cayman Islands to hide the bribe payments. In July 1994, Russo travelled to the Cayman Islands to meet with John Mathewson, chairman of Guardian Bank and Trust. Russo asked Mathewson to incorporate a new company called Hanson Corporation and to open a bank account in the name of Hanson. Thereafter, Russo's Leasing Ventures would funnel bribes to the General Instrument employee through Hanson. To make these transfers appear legitimate, Mathewson would issue back dated fake invoices to Leasing Ventures, in the same amount as the bribes paid, relating to a "sale" of cable equipment by Hanson to Leasing Ventures. The cheques that Leasing Ventures deposited in Guardian Bank and Trust were sent to the United States where a correspondent bank stamped the cheques on US territory, thereby ensuring no Cayman Islands connection. The bribe payments were withdrawn from Hanson's account through the use of a Visa Gold card issued by Guardian Bank and Trust. The FBI finally arrested Russo and Mathewson in 1996. By that time, Mathewson was living in the United States, having left the Cayman Islands in 1995 after the island's authorities shut down Guardian Bank and Trust.

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Sources: 1998 UN Report, p. 41; "Operation Cabletrap – indictment", News Release by US Attorney for the District of New Jersey (21 June and 27 June 1996); O'Neill, Eamonn, *Notes from a Small Island*, Sunday Herald (23 January 2000); Euroshore Report, p. 81 (January 2000); Cayman Banker Assists US Tax Evasion and Money Laundering Investigation, Baker and McKenzie Private Banking Newsletter, October 1999; Ronald Smothers, *Banker Outlines Money Laundering in Caymans*, The New York Times, 3 August 1999.

### III. Case studies on hiding and shielding assets from creditors and other claimants

The case studies below demonstrate the difficulty in tracing assets hidden in overseas companies and trusts and the obstacles encountered in the attempt to repatriate illegal proceeds.

#### Alan Bond Case

This case involves the alleged use of a variety of corporations and trusts to hide money from creditors. In 1990, former Australian billionaire Alan Bond was declared bankrupt, with personal debts of A\$470 million. Bond's private company, Dallhold Investments, and public company, Bond Corporation Holdings (Southern Equities), were in liquidation, having incurred billions of dollars of debt. Despite Bond's declaration that he had no assets overseas, Australian authorities had long suspected that Bond had concealed millions of dollars of cash and other assets from creditors through the use of offshore trusts and companies.

Bond's trustee in bankruptcy alleged that Bond hid his assets in the following manner. In the late 1970s, Bond, through his Australian solicitor, established a Jersey company called Pianola. This company was owned by Juniper Trust, which authorities believed was beneficially owned by Bond. Juniper Trust's initial trustee was Walbrook Trustees Jersey Pty Ltd, a trustee company established by a firm of accountants for use by various clients including Bond. Later, Enterprise SA, a Panamanian company, replaced Walbrook as trustee of Juniper. Enterprise, in its capacity as trustee of Juniper Trust, held shares in a company called Kirk Holdings. Kirk Holdings was established in Panama. Bearer shares in Kirk Holdings were forwarded to Jersey and a power of attorney from the company was granted to Bond's Swiss banker friend, Jurg Bollag, enabling him to exercise complete control over the company and bank accounts without being a registered shareholder, director or secretary. Kirk Holdings served as the conduit through which millions of dollars were funnelled from Bond and Bond Corporation.

Most of the funds received by Kirk Holdings was subsequently wired to the Swiss bank accounts of Juno Equities, a Panamanian registered company incorporated by Bollag and also believed to be beneficially owned by Bond. In addition to serving as vehicles through which money was transferred, these entities were also alleged to have held properties, equestrian horses, and paintings. Bond never acted directly in these transactions, instead using Bollag to relay his instructions. In the end, Bond's creditors opted for a settlement of A\$ 10.25 million (A\$ 3.25 million for his personal creditors and A\$ 7 million for the creditors of Dallhold Investments). The bankruptcy was annulled under Australian law and further attempts at asset realisation or tracing ceased.

Source: (Author unknown), *Law 502 – Trusts, Chapter 10: Maximising Business Interests* (case study on Bond bankruptcy), Paul Barry, *Why Bond has the last laugh*, The Sydney Morning Herald, p. 13 (14 August 2000).

### Anderson Case

This case involved the use of an offshore trust in the Cook Islands to illegally shield assets from creditors, aided by a creditor-unfriendly trust law in that jurisdiction. Denyse and Michael Anderson operated a telemarketing venture, which was essentially a Ponzi scheme, that promised investors a 50 per cent return in 60 to 90 days. Two years earlier, the Andersons created an irrevocable asset protection trust under the laws of the Cook Islands and appointed themselves and AsiaCiti Trust Limited, a licensed Cook Islands trust company, as co-trustees. The trust deed contained an “event of duress” clause that permitted the co-trustee, AsiaCiti, to ignore any instruction given by the Andersons if the instruction was given under “duress.” Under the trust deed, the occurrence of an event of duress would also automatically lead to the removal of the Andersons as co-trustees.

With thousands of investors suffering losses in the Andersons' scheme, the US Federal Trade Commission (FTC) filed a complaint in federal court against the Andersons, charging them with fraudulent conduct. Shortly thereafter, the federal court entered a preliminary injunction against the Andersons, requiring them to repatriate all assets held outside of the United States. In response, the Andersons sent a fax to AsiaCiti, co-trustee of the trust, instructing them to provide an accounting of the assets held in the trust and to repatriate all assets to the United States. Thereafter, AsiaCiti notified the Andersons that the temporary restraining order operated as an “event of duress” under the trust. Consequently, AsiaCiti would not comply with the Andersons' instructions and furthermore, the Andersons would be removed as co-trustees.

Due to their failure to repatriate all of their assets to the United States and to provide an accounting for the trust, the federal court found the Andersons to be in civil contempt and placed them in jail. After spending six months in jail, the Andersons decided to co-operate with the FTC and agreed to designate a new Cook Islands company, FTC, Inc. (wholly-owned by the FTC), as the sole trustee of the Anderson trust. The High Court of the Cook Islands rejected this action, citing that the FTC, as an “excluded party” under the trust deed, could not benefit from the trust in anyway.

Having exhausted all of its remedies in the United States, the FTC then brought an action in the Cook Islands, arguing that the transfer of illegal proceeds into the trust constituted fraudulent conveyance under Cook Islands law. However, it is quite difficult to prove fraudulent conveyance under the Cook Islands International Trusts Act, which requires a creditor to prove 1) a transfer into a trust was made with an intent to defraud creditors and 2) at the time the creditor's claim arose, the debtor was insolvent. The case is still pending in the High Court of the Cook Islands.

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Source: *The Anderson Case*, Baker and McKenzie Private Banking Newsletter, October 1999; Mario A. Mata, *Offshore Trusts and Other Asset Protection Devices*, 2 April 2000 (at [www.clla.org/articles/MATA.html](http://www.clla.org/articles/MATA.html)); Stewart E. Sterk, *Asset Protection Trusts: Trust Law's Race to the Bottom*, *Cornell Law Review*, Spring 2000.

#### IV. Case studies on illicit tax practices

The case examples provided below provide an illustration of the various ways corporate vehicles can be misused to perpetrate illicit tax practices.

##### **Case: Use of Corporate Vehicles to Evade Taxes**

In one sophisticated scheme, promoters instruct individuals to transfer their businesses, including income earned during the year, to a trust or asset management company (AMC). Next, promoters instruct clients to form a trust with nominee directors in an OFC. All income earned by the business that was transferred to the AMC is then distributed to the foreign trust. The trustee of the foreign trust is the AMC. The promoters then instruct individuals to form a second foreign trust also located in an OFC. All the income, less some fraudulent expenses, is distributed from the first foreign trust to the second foreign trust. The first foreign trust is the trustee of the second foreign trust and Certificates of Beneficial Interest (CBIs) are issued to the first foreign trust or other foreigner controlled by the taxpayer. At this point, according to the promoters, the income transferred to the second foreign trust is now outside US tax jurisdiction. Promoters claim that since the source of the income and the beneficiary are foreign, there is no US tax return filing requirements.

Source: *International Narcotics Control Strategy Report*, 1999.

##### **Export Trade to Russia – Double Invoicing**

European Union and Russian authorities have recently voiced concern over the widespread use of double invoicing to evade Russian customs taxes. The scheme typically involves the use of two invoices – a legitimate invoice presented to the customs authorities in the exporting country and a falsified invoice (undervaluing the value of the goods by up to two-thirds) presented to Russian customs authorities. Goods to be exported to Russia would typically be “sold” first to one or a series of front companies to muddle the paper trail. The last of these front companies would then prepare the falsified invoice to present to the Russian customs authorities. Once the goods have cleared customs, they are quickly unloaded through various front companies, some of which cease to exist after the goods pass through them. Again, this process is intended to make it difficult for Russian authorities to trace the true origin or destination of the goods.

This scheme is highly attractive to both exporters and importers. Export firms, which usually face higher labour and other input costs, get the opportunity to compete in Russia at attractive rates while the import firms save in customs and other taxes.

Source: *Use of front companies and tax havens widespread in the export trade to Russia*, Helsingin Sanomat (International Edition), 26 september 2000.

## V. Case studies on self-dealing/defrauding assets/diversion of assets cases

The following case studies provide examples of how corporate vehicles can be used to commit these types of fraud.

### **Russia: Profit Skimming and Capital Flight**

In recent years, many immensely profitable enterprises in Russia have been victims of profit skimming by managers and other insiders. This process, also known as “tolling” or “transfer pricing”, involves selling goods to an intermediary company at below-market prices; the intermediary then resells the goods at market prices and keeps all of the profits. Often, these transactions are conducted to evade taxes. Tolling transactions become asset stripping when the management or the controlling shareholder of a firm devises these schemes in order to benefit themselves (*e.g.*, when the foreign intermediary companies are owned by the same managers or controlling shareholder). For example, Avisma, a leading titanium producer based in city of Perm in Siberia, was quite profitable prior to privatisation. After Bank Menatap purchased a controlling stake in Avisma, the company redirected foreign sales to an intermediary company, TMC (Holdings), at a fraction of the then-prevailing market prices, instead of selling its titanium directly to customers abroad. TMC (Holdings), a company registered in Ireland, was owned by Valmet, an Isle of Man company, which, in turn, was partly owned by Bank Menatap, the financial institution that bought Avisma when it was privatised. In April 1999, the Russian government retook control of Avisma, alleging that Bank Menatap had siphoned the company's profits and hid them in Valmet's accounts. In certain companies, profits skimming was practised to such an extent that companies soon were unable to pay their workers or invest in new equipment.<sup>1</sup>

Russian banks have also been known to funnel money abroad by disguising the transfers as loans to dummy companies that are sometimes controlled by the officers of the Russian bank. The dummy companies then transfer the “loan” through multiple accounts in different jurisdictions to obscure its origin. The original dummy company would then default on its loan obligations and the bank writes off the loan.<sup>2</sup> The now defunct Russian bank, Inkombank, has been accused to have used a Liechtenstein company, Tetra Finance Establishment, to divert the bank's money offshore. Tetra Finance Establishment is controlled by the principals of Inkombank.<sup>3</sup> These types of abuse have resulted in the vast majority of Russians keeping the savings in cash (approximately US\$40 billion) under their mattresses.

While currency controls exist in Russia, various schemes have been devised to circumvent these regulations. For example, a Russian might pay a foreign company that he secretly controls US\$100 000 for consulting services.



### Russia: Profit Skimming and Capital Flight (cont.)

Some of the capital that has been funnelled illegally abroad has returned to Russia, disguised as foreign investment. Many of the firms that have "invested" in Russia were incorporated in OFCs, particularly Cyprus. In 1996 and in the second quarter of 1999, the fourth largest investor in Russia was Cyprus, a country of 750 000 people, and in 1996, Liechtenstein, a tiny principality of 31 000 people, came in ninth.<sup>4</sup> However, some of these companies were incorporated in Western countries, such as Germany, United Kingdom, Ireland, Switzerland, and the United States, in order to benefit from the protection of these countries' laws and to reduce the likelihood of seizure by Russian authorities.<sup>5</sup>

1. Bernard S. Black, Reinier Kraakman, and Anna Tarassova, *Russian Privatization and Corporate Governance: What Went Wrong?*, Stanford Law Review, Vol. 52, 2000
2. R.G. Gidathubli and Rama Sampath Kumar, Causes and Consequences of Money Laundering in Russia, 27 November 1999, at [www.epw.org.in/34-48/sa3.htm](http://www.epw.org.in/34-48/sa3.htm).
3. James Bone and David Lister, Fresh Claim About Banker in "Dirty Cash", London Times, 4 November 1999.
4. James Bone and David Lister, Fresh Claim About Banker in "Dirty Cash", London Times, 4 November 1999.
5. US House of Representatives, Statement of Richard Palmer of Cachet International, Hearing on the Infiltration of the Western Financial System by Elements of the Russian Organised Crime, 21 September 1999.

Source: Andrew Higgins, Alan S. Cullison, Michael Allen, and Paul Beckett, Brash Banker's Tangled Deals Become a Focus of Money-Laundering Probes, Wall Street Journal, 26 August 1999; Timothy O'Brien, Follow the Money, if You Can, The New York Times, 5 September 1999.

### Sagaz Case

In March 1998, Gabriel Sagaz, the former president of Domecq Importers, Inc., pled guilty to a charge of conspiracy to defraud for actions that had taken place between 1989 and 1996. Sagaz and several colleagues had embezzled over US\$13 million directly from the company and received another US\$2 million in kickbacks from outside vendors who issued invoices for false goods and services. Sagaz approved the phoney invoices and, after Domecq Importers, Inc. paid the vendors, the vendors issued checks to shell corporations controlled by Sagaz and his colleagues.

Source: 1998 UN Report, p. 41; "Former president of American subsidiary of world's No. 2 liquor company pleads guilty to embezzlement, and kickback conspiracy", US Department of Justice News Release (12 March 1998).

## VI. Case study on circumvention of disclosure requirements

The following case study demonstrates the use of corporate vehicles to circumvent disclosure requirements.

### **Citron [(SEC v. Glittergrove Investments Ltd., 99 Civ. 1153 (SHS) (S.D.N.Y. 1999)]**

In March 1999, the United States Securities and Exchange Commission ("SEC") obtained a preliminary injunction against Glittergrove, an Irish corporation with addresses in Ireland, Jersey and the Isle of Man. The complaint alleged that Glittergrove and seven other offshore entities (the "Offshore Entities") participated in unregistered distributions of the common stock of two companies: Citron, Inc. ("Citron") and Electronic Transfer Associates, Inc ("ETA"). Citron and ETA were controlled by Peter Tosto. Fortress Management, Ltd., an incorporation consultant, incorporated six of the Offshore Entities in the Isle of Man.

The Offshore Entities appear to have acquired shares comprising the bulk of the outstanding common stock of Citron and ETA. In January 1999, there were sharp price increases in Citron and ETA, based at least in part on heavy trading by the Offshore Entities. The SEC requested the assistance of the Isle of Man's Attorney General in obtaining information, including bank records, about the Offshore Entities incorporated in the Isle of Man. The Attorney General assisted the SEC by providing extensive documents, including incorporation documents from Fortress Management Ltd. These documents helped to demonstrate Tosto's connection to the Offshore Entities incorporated in the Isle of Man, thus linking Tosto to the unregistered distributions of Citron and ETA. The Court entered a default judgment against Glittergrove in June and is currently working out a distribution plan for Glittergrove's assets frozen in the US. The SEC continues to investigate other issues arising from these facts.

Source: US Securities and Exchange Commission.

Annex II

## G-7 Finance Ministers Principles on International Cooperation and Information Sharing

### A. G-7 Ten Key Principles on Information Sharing (1998)

**1. Authorisation to share and gather information:** Each Supervisor should have general statutory authority to share its own supervisory information with foreign supervisors, in response to requests, or when the supervisor itself believes it would be beneficial to do so. The decision about whether to exchange information should be taken by the Provider, who should not have to seek permission from anyone else. A provider should also possess adequate powers (with appropriate safeguards) to gather information sought by a Requestor.

*Lack of sufficient authority can impede information sharing. Without a power to gather information for other supervisors, a Provider may be limited to providing only information it already holds, or it can obtain from public files.*

**2. Cross-sector information sharing:** Supervisors from different sectors of financial services should be able to share supervisory related information with each other both internationally (eg a securities supervisor in one jurisdiction and a banking supervisor in another) and domestically.

**3. Information about systems and controls:** Supervisors should co-operate in identifying and monitoring the use of management and information systems, and controls, by internationally active firms.

**4. Information about individuals:** Supervisors should have the authority to share objective information of supervisory interest about individuals such as owners, shareholders, directors, managers or employees of supervised firms.

*Supervisors should be able to share objective information about individuals as they can about firms and other entities.*

**5. Information sharing between exchanges:** Exchanges in one jurisdiction should be able to share supervisory information with exchanges in other jurisdictions, including information about the positions of their members.

*Exchanges have a supervisory function in many jurisdictions. Where they do, they need to be able to share supervisory information to form a view on the potential impact of market events, on its members, and on the customers, counterparties, and financial instruments affected by it.*

**6. Confidentiality:** A Provider should be expected to provide information to a Requestor that is able to maintain its confidentiality. The Requestor should be free to use such information for supervisory purposes across the range of its duties, subject to minimum confidentiality standards.

*While most Providers, quite properly, require a Requestor to maintain the confidentiality of information, as a condition of providing it, they should not seek to limit its use, by the Requestor in carrying out its supervisory*

duties, including use in connection with (depending on legal arrangements in the country) administrative, civil or criminal cases where the Requestor, or another public authority, is a party to an action which arise from the exercise of those duties.

**7. Formal agreements and written requests:** The Requestor should not have to enter into a strict formal agreement in order to obtain information from a Provider. Nor should a written request be a prerequisite to the sharing of information, particularly in an emergency.

*Information sharing arrangements, such as Memoranda of Understanding are often used to establish a framework among supervisors and can facilitate the efficient execution of requests. But the existence of such an agreement should not be a prerequisite for information sharing. Written requests can also be useful at times to provide an efficient and effective way of dealing with information requests, but, again, their absence should not be used to justify delaying a response.*

**8. Reciprocity requirements:** These, too, should not be a strict precondition for the exchange of information, but the principle of reciprocity may be a consideration.

*As with formal agreements, reciprocity can often be a way of encouraging and facilitating information exchange but the lack of reciprocity in a particular case should not be used by a provider as the only reason for not exchanging information that it would otherwise have been willing to share, especially in emergency cases.*

**9. Cases which further supervisory purposes:** In order to ensure the integrity of firms and markets, the Provider should permit the Requestor to pass on information for supervisory or law enforcement purposes to other supervisory and law enforcement agencies in its jurisdiction that are charged with *enforcing* relevant laws, in cases which further supervisory purposes.

*The criminal, civil and administrative components of a jurisdiction's securities, banking and insurance laws are sometimes enforced by a number of agencies. Restrictions should not be so onerous that they can prevent the effective sharing of information. For example, exchange of information between supervisors, in cases which further supervisory purposes, should not be subject to the constraint that it cannot be passed to criminal authorities, though this should not be used to circumvent established channels of co-operation.*

**10. Removal of laws preventing supervisory information exchange:** To facilitate co-operation between the supervisors of internationally-active groups, each jurisdiction should take steps to remove or modify those laws and procedures that prevent or impede the exchange of necessary supervisory information.

*Laws and procedures can impede information sharing unless there are suitable gateways which allow jurisdictions to share information for supervisory-related purposes.*

## **B. G-7 Ten Key Principles for the Improvement of International Cooperation Regarding Financial Crime and Regulatory Abuse (1999)**

The Denver Summit remitted countries to take steps to improve international co-operation between law enforcement authorities\* and financial regulators on cases involving serious financial crime and regulatory abuse. In making these improvements, and seeking to improve spontaneous and "upon request" international information exchange in this field, countries should adhere to the key principles set out below.

\* Law enforcement authorities include any authorities exercising law enforcement functions, including conducting criminal proceedings.

While remaining consistent with fundamental national and international legal principles and essential national interests, countries should:

1. ensure that their laws and systems provide for the maximum co-operation domestically between financial regulators and law enforcement authorities in both directions. In particular, when financial regulators identify suspected financial crime activity in supervised institutions or financial markets, they should share this information with law enforcement authorities or, if applicable, the national Financial Intelligence Unit;
2. ensure that there are clear definitions of the role, duty, and obligations of all the national authorities involved in tackling illicit financial activity;
3. provide accessible and transparent channels for co-operation and exchange of information on financial crime and regulatory abuse at the international level including effective and efficient gateways for the provision of information. Instruments such as Memoranda of Understanding and Mutual Legal Assistant Treaties can be very valuable in setting out the framework for co-operation but their absence should not preclude the exchange of information;
4. at the international level, either introduce or expand direct exchange of information between law enforcement authorities and financial regulators or ensure that the quality of national co-operation between law enforcement authorities and financial regulators permits a fast and efficient indirect exchange of information;
5. ensure that law enforcement authorities and financial regulators are able to supply information at the international level spontaneously as well as in response to requests and actively encourage this where it would support further action against financial crime and regulatory abuse;
6. provide that their laws and systems enable foreign financial regulators and law enforcement authorities with whom information on financial crimes or regulatory abuse is shared to use the information for the full range of their responsibilities subject to any necessary limitations established at the outset;
7. provide that foreign financial regulators and law enforcement authorities with whom information on financial crimes or regulatory abuse is shared are permitted, with prior consent, to pass the information on for regulatory or law enforcement purposes to other such authorities in that jurisdiction. Proper account should be taken of established channels of co-operation, such as mutual legal assistance statutes and treaties, judicial co-operation, Memoranda of Understanding, or informal arrangements;
8. provide that their law enforcement authorities and financial regulators maintain the confidentiality of information received from a foreign authority within the framework of key principles 6 and 7, using the information only for the purposes stated in the original request, or as otherwise agreed, and observing any limitations imposed on its supply. Where an authority wishes to use the information for purposes other than those originally stated or as otherwise previously agreed, it will seek the prior consent of the foreign authority;
9. ensure that the arrangements for supplying information within regulatory and law enforcement co-operation framework are as fast, effective and transparent as possible. Where information cannot be shared, parties should as appropriate discuss the reasons with one another;
10. keep their laws and procedures relating to international co-operation on financial crimes and regulatory abuse under review to ensure that, where circumstances change and improvements can be made, an appropriate response can be implemented as quickly as possible.

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