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Anonymous companies

How hidden company ownership is a major barrier in the fight against poverty and what to do about it

Photo: AP/Schalk van Zuydam

Anonymous shell companies allow corrupt politicians to siphon off state funds, which could be spent on schools, hospitals and other vital services

What's the problem?

Money launderers, corrupt politicians, terrorists, arms traffickers, drug smugglers, and tax evaders all rely on two things to move their dirty money: company structures that allow them to hide their identity, and banks and other professionals willing to do business with them. Both are currently all-too available.

"Corporate opacity is not inadvertent: it is the cumulative achievement of the sustained effort of some of the most brilliant professional minds on the planet. These people should hang their heads in shame."

Paul Collier, development economist[1]

Anonymous shell companies facilitate the corruption that keeps poor countries poor

> *"Corruption [is] among the greatest obstacles to economic and social development"*
>
> The World Bank[2]

The issue of hidden company ownership is high on the political agenda and the British Prime Minister David Cameron has made it a priority for the UK's 2013 G8 presidency. In April 2013 he wrote to his fellow European leaders, calling on the EU and the G8 to work together to "break through the walls of corporate secrecy' in order to tackle corruption and tax dodging.[3]

Moves like this would have a major impact on efforts to tackle poverty. Payments for oil, minerals, and other natural resources will be the largest inflow of wealth to Africa for the foreseeable future. In 2010, the value of exports of oil and minerals from Africa was worth $333 billion, about six times the value of exported agricultural products ($55 billion) and nearly nine times the value of international aid ($39 billion).[4]

This huge transfer of wealth could be one of the best chances in a generation to lift many of the world's poorest out of poverty. Yet so far it has not worked out that way. Economist Paul Collier has noted that of the world's poorest one billion people, one-third live in resource-rich countries. However, as a result of weak governance and widespread corruption, these finances do not always reach government accounts. In fact, many of these resource-rich countries have been looted by the very politicians who have been entrusted with developing their country's economy.

It is primarily companies that are used to move dirty money. The World Bank reviewed 213 big cases of corruption between 1980 and 2010.[5] More than 70% of them relied on anonymous shell companies. And those anonymous companies did not just come from sunny Caribbean islands. Instead, companies registered in the United States topped the list, and the UK and its crown dependencies and overseas territories came second.

Global Witness' investigations have shown how through the use of opaque corporate structures, the people of the Democratic Republic of Congo lost out on billions of dollars of revenues when their copper and cobalt mines were sold. The mines were bought by companies incorporated in the British Virgin Islands at a fraction (sometimes 1/16th) of their real value, then sold on – to FTSE 100 companies – for closer to their true market value. In doing so, someone pocketed a fortune (we don't know who) and billions were diverted from state coffers.[6] Similarly, the son of Equatorial Guinea's president used California shell companies to purchase a $30 million home in Malibu and a BVI shell company to purchase a Gulfstream jet, despite his meagre official salary.[7] Both of these countries, DR Congo and Equatorial Guinea, are rich in natural resources, but flounder at the bottom of the human development index.

It is extremely easy to set up anonymous companies and trusts

> *"Almost every economic crime involves the misuse of corporate vehicles [i.e. companies and trusts]"*
>
> OECD, 2001[8]

It is quick, easy and relatively cheap to create complex corporate structures spanning multiple countries that disguise the ultimate owner and controller. The identity of the people involved in such structures can easily be obscured in two ways:[9]

- by incorporating one or more of the companies in a secrecy jurisdiction, in other words, in a country which does not make details of the shareholders, beneficial owners or directors publicly available.
- by using 'nominees'. Nominees are people who front a company in place of the true owners or directors. They are legal in the vast majority of countries, and there is typically no requirement to disclose that the names listed are merely front-people.

WHAT IS A 'BENEFICIAL OWNER'?

A 'beneficial owner' is a natural person – that is, a real, live human being, not another company or trust – who directly or indirectly exercises substantial control over the the company or receives substantial economic benefits from the company.

The recommendations set out by the Financial Action Task Force (FATF), the body that sets the global anti-money laundering standards, specify that the identity of the real, beneficial owners of a company must be available to the authorities in an adequate, accurate and timely manner.[10] The usual way that countries attempt to comply with this is by requiring banks and other professions such as lawyers and company service providers to have to find out the beneficial owner of corporate clients. This system does not work.

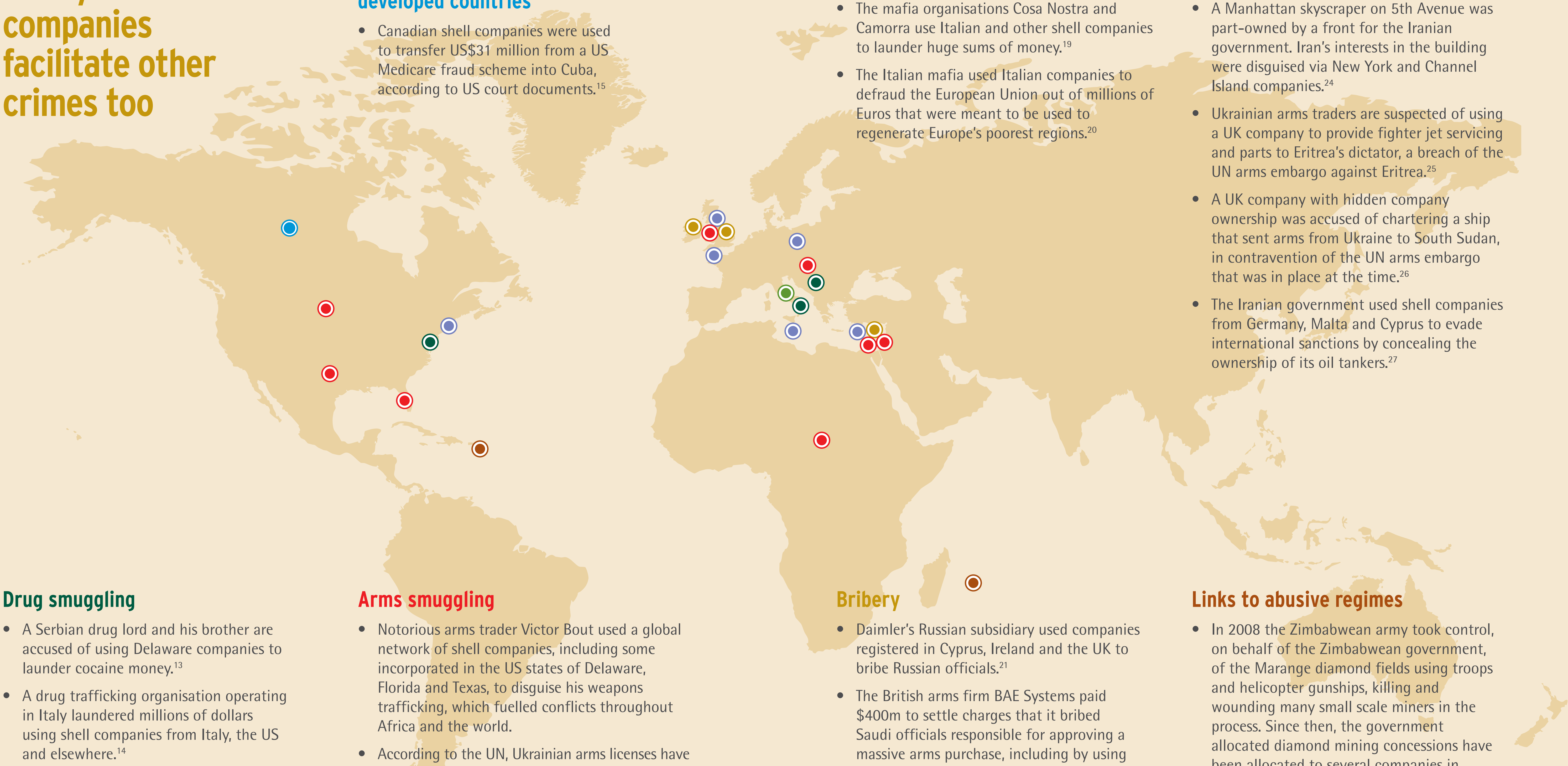
Photo: Fabio Rodrigues Pozzebom / ABr

President Obiang of Equatorial Guinea: His son used California shell companies to purchase a $30 million home in Malibu and a BVI shell company to purchase a Gulfstream jet, despite his meagre official salary.

- **It is easy to avoid having any due diligence carried out.** In lots of countries, including the UK, it is possible to avoid having any record created of who is behind a company, by incorporating the company direct with the corporate registry, and not via a company service provider.
- **In many countries company service providers are all-too-willing to flout the law.** A mystery shopping exercise tested how easy it is to circumvent the FATF's rules on ensuring beneficial ownership information is available. Emails were sent to over 3,000 company service providers worldwide to see if they would set up a company without knowing who the beneficial owner is. An alarming 48% of the companies that replied were prepared to set up an anonymous company. Contrary to expectations, company service providers in the US and UK were more likely to set up an anonymous company than those in secrecy jurisdictions such as the Seychelles. .
- **A large number of the world's major economies are ineffective in preventing companies from being misused by money launderers.** FATF carries out reviews of how well each country is implementing its recommendations. Six of the eight G8 countries are listed as being 'not compliant' or only 'partially compliant' with the recommendation on beneficial ownership.[11] Similarly, 18 of the 27 EU member states are listed as being 'not compliant' or only 'partially compliant' with the recommendation.[12]
- **Many countries do not require banks, lawyers and company service providers to identify the beneficial owner of all corporate clients.** For example, in the US banks are not required to identify the beneficial owners for all accounts, and lawyers and company service providers do not have customer due diligence requirements.

The penalty in the UK and US for having fake ID in the form of a passport is up to ten years in prison. And yet anyone willing to pay a small amount of money can create the fake ID of a company, and then use this company to hide behind.

Anonymous companies facilitate other crimes too



Corruption in developed countries

- Canadian shell companies were used to transfer US$31 million from a US Medicare fraud scheme into Cuba, according to US court documents.[15]

Mafia

- The mafia organisations Cosa Nostra and Camorra use Italian and other shell companies to launder huge sums of money.[19]
- The Italian mafia used Italian companies to defraud the European Union out of millions of Euros that were meant to be used to regenerate Europe's poorest regions.[20]

Sanctions busting

- A Manhattan skyscraper on 5th Avenue was part-owned by a front for the Iranian government. Iran's interests in the building were disguised via New York and Channel Island companies.[24]
- Ukrainian arms traders are suspected of using a UK company to provide fighter jet servicing and parts to Eritrea's dictator, a breach of the UN arms embargo against Eritrea.[25]
- A UK company with hidden company ownership was accused of chartering a ship that sent arms from Ukraine to South Sudan, in contravention of the UN arms embargo that was in place at the time.[26]
- The Iranian government used shell companies from Germany, Malta and Cyprus to evade international sanctions by concealing the ownership of its oil tankers.[27]

Drug smuggling

- A Serbian drug lord and his brother are accused of using Delaware companies to launder cocaine money.[13]
- A drug trafficking organisation operating in Italy laundered millions of dollars using shell companies from Italy, the US and elsewhere.[14]

Arms smuggling

- Notorious arms trader Victor Bout used a global network of shell companies, including some incorporated in the US states of Delaware, Florida and Texas, to disguise his weapons trafficking, which fuelled conflicts throughout Africa and the world.
- According to the UN, Ukrainian arms licenses have been given to UK shell companies involved in supplying helicopter parts to Syria, military kit to Gaddafi's Libya and nuclear technology to Lithuania.[16]
- Slobodan Milosevic used a network of thousands of Cypriot front companies in order to provide arms for the war against Bosnia and Kosovo.[17]
- Convicted arms dealer Pierre Falcone used a US shell company to bring millions of dollars of suspect funds into the US.[18]

Bribery

- Daimler's Russian subsidiary used companies registered in Cyprus, Ireland and the UK to bribe Russian officials.[21]
- The British arms firm BAE Systems paid $400m to settle charges that it bribed Saudi officials responsible for approving a massive arms purchase, including by using UK shell companies.[22]
- Russian gangsters used Cypriot shell companies to launder millions of Euros of that were stolen when state assets were being privatised.[23]

Links to abusive regimes

- In 2008 the Zimbabwean army took control, on behalf of the Zimbabwean government, of the Marange diamond fields using troops and helicopter gunships, killing and wounding many small scale miners in the process. Since then, the government allocated diamond mining concessions have been allocated to several companies in questionable circumstances. Mbada Diamonds, which is partly controlled through companies registered in the British Virgin Islands and Mauritius, is one such company. It is run by a man widely reported to be Zimbabwean President Mugabe's former helicopter pilot.[28]

How to stop abuse of anonymous companies

Countries should require companies to put information about their beneficial owner(s) in the public domain, available for free, in open data format, in line with agreed standards. The easiest way to achieve this involves using existing corporate registries, whether currently compiled at a national or sub-national level. Similarly, countries should require the names of the people behind trusts and foundations to be put in the public domain. Tightly defined exemptions should be available for companies with legitimate security concerns. These companies could apply to the authorities for an exemption for having to reveal their beneficial ownership information.

It is essential that beneficial ownership information is in the public domain, as opposed to only being accessible to the police or other law enforcement authorities. This is because it can be exceptionally difficult for other countries to access closed sets of information through the often cumbersome, expensive and time-consuming process of mutual legal assistance. This is especially true for developing countries that may have limited capacity. Having beneficial ownership information in the public domain also allows citizens, journalists and civil society to hold companies (and their owners) to account for their actions.

Requiring beneficial ownership information to be put in the public domain is cheap. There have been two cost/benefit analyses carried out looking at the costs of a beneficial ownership registry: one done by the UK in 2002[29] and one done by the European Commission in 2007.[30] Both concluded that public registries of beneficial ownership would be more cost effective than the status quo. For the UK, it was estimated that including beneficial ownership information in a register that is searchable and updated as ownership changes would cost the UK £2.8m to set up and £8.2m per year to run.[31] There are additional benefits and cost savings of doing this. For example, it would save police time in their investigations, which is estimated to be £30.3m a year.[32] Global Witness commissioned the same consultants who carried out the 2002 cost benefit analysis to update the costs figures.

Photo: AP /David Longstreath.

Victor Bout, a convicted arms dealer, used American shell companies to disguise his weapons trafficking.

	Costs to the private sector	Costs to the public sector
One-off transition costs	£29.67 million	£38.6 million
Annual costs	£4.11 million	£10.76 million

Table 1: The costs to the private and public sectors in the UK of putting companies' beneficial ownership information in the public domain

Their conclusions, which are in the table below, demonstrate that putting beneficial ownership information into the public domain is cheap for the public and private sectors. The full report is available on Global Witness' website.[33]

Requiring beneficial ownership information to be put in the public domain does not involve much red tape. For example, in the UK it is estimated that only 1% of companies have beneficial owners who are distinct from their legal shareholders. In other words, 99% of companies would find it extremely easy to know who their beneficial owner is.[34]

Countries should put pressure on the secrecy jurisdictions with which they have relationships – in particular, the UK and its Overseas Territories and Crown Dependencies – to adopt a similar standard.

Banks are too willing to do business with anonymous companies

According to conservative estimates more than $450 billion illicitly left African countries during the last decade (2001 – 2010). Money flows on this kind of scale could not happen without the willingness of banks and other professionals (like estate agents and lawyers) to facilitate the movement of the money. As Paul Collier has pointed out, bribery takes three to tango: not just the bribed and the bribing company, but also the facilitator.[35]

Banks stand to make big profits from accepting the business of rich, dodgy customers. And yet despite the existence of fairly stringent-sounding anti-money laundering laws, the risks they face for taking tainted assets are small. Banks are rarely caught and when they are, the punishment is small: the fines may seem large to members of the public, but are often only a fraction of the bank's profits; and there is very limited personal responsibility from individual bankers.

> *"If you are an important person, and you work for a big international bank, you won't be prosecuted even if you launder nine billion dollars. Even if you actively collude with the people at the very top of the international narcotics trade, your punishment will be far smaller than that of the person at the very bottom of the world drug pyramid."*
>
> Matt Taibbi on the HSBC settlement[36]

The recent case involving HSBC is a strong example of this. In 2012 the bank agreed to pay a record $1.9 billion fine by US authorities after admitting to systematic anti-money laundering failings, including laundering at least hundreds of millions of dollars for drugs cartels, terrorists and pariah states. During this time 47,000 people died in Mexico at the hands of drug traffickers. The Senate Sub-Committee which carried out the investigation uncovering this described HSBC's culture as "pervasively polluted".[37]

HSBC's problems cannot be blamed on a few momentary lapses in judgement by low-level compliance officers. Top management received repeated warnings from regulators over the course of a decade, yet failed to clean up the bank. The fine faced by HSBC – $1.9 billion – is the biggest penalty regulators have ever given to a bank. Yet this represents just 8.5% of its pre-tax profits for 2012.[38] Fines paid by Standard Chartered, ING, Credit Suisse and other big banks for violating US sanctions over recent years show a similar pattern – all represent less than 10% of one year's pre-tax profits.

More importantly, the problem with fines is that they hurt the banks' shareholders, either through smaller dividends, or through reduced investment in the bank's business, not the bankers who were responsible for breaking the law. It's a case of 'heads I win, tails you lose' – individual bankers continue to get rich on bonuses while shareholders lose out when banks are punished. Punishments that target the wrong people don't incentivise behaviour change by the bank.

Recent evidence suggests that banks are all too willing to turn a blind eye to dirty money. In 2011, the UK's Financial Services Authority (now the Financial Conduct Authority) carried out a survey of 27 UK banks, including all the major ones, to see how well they were doing in implementing the anti-money laundering laws. They particularly focused on the accounts of senior foreign politicians. Ordinary people may be in a position sometimes to steal money, but unscrupulous senior politicians can be in a position to steal significant amounts of a whole country's money, so banks are required to do extra checks on them. And yet they found that **more than half of UK banks did not do any extra checks on the politicians and three quarters of them did not find out what the source of their money was, as they are required to do by law**.

Within banks, compliance is all too often seen as a cost, rather than a profit centre. Compliance officers that Global Witness have spoken to describe how they often do not feel empowered to challenge the decisions of the business units. In most banks it is the relationship manager (the person responsible for bringing business in), rather than the compliance officer, who has the final say over whether a prospective customer is accepted. It is vital that the inbalance of power between these two roles is changed so that there is a greater emphasis on compliance to ensure banks' obligations to meet anti-money regulations are not deprioritised for greater profit.

Another significant barrier to lawful and ethical behaviour in the banking industry is the way in which bank staff are rewarded for their behaviour. At the moment, the pay of bankers is almost exclusively linked to how much money they make for their institution, rather than whether their behaviour is compliant with applicable rules and regulations or even in the long term interests of all their customers.

How to stop banks taking money from corrupt politicians

The main way to prevent banks from facilitating money laundering is to ensure there is a more effective system of deterrents. Senior people within banks need to be held individually responsible for the actions of their institutions; sanctions need to be sufficiently dissuasive; and that regulators must improve the way they enforce the existing rules which make it illegal to accept dirty money. At the very least, a board member needs to be explicitly responsible for a bank's compliance with the anti-money laundering due diligence rules. Banks should also tie remuneration to how "compliant" a bank is: senior bankers' bonuses should be clawed back if the bank was complicit in laundering money; and senior individuals should be prevented from working in the industry. In the most egregious cases, they should be indicted and face jail if convicted.

Sanctions for banks should also be increased from the current levels being imposed in order to be more dissuasive. The basis for calculating financial **penalties** needs to be revised to ensure that it is in banks financial interests to properly comply with the anti-money laundering laws. The starting point should be that if a bank has committed serious breaches of the rules it should lose all the revenue it made from its illegal activity plus be faced with an extra penalty as a deterrence.

Action is also needed from **regulators** to improve the way they enforce existing regulations. As a start they should carry out mystery shopping exercises to see how well banks' compliance procedures work in practice. It is not enough merely to examine an institution's policies. Countries should follow the FSA's example and carry out reviews of how well their banks are dealing with money laundering risk, and in particular the threat to their financial system from corrupt money.

Another way to stop banks from taking dirty money is to take action to improve the way they carry out due diligence on high risk customers. Banks should be required to annually review the business they do with Politically Exposed Persons (PEPs): public officials who by dint of their position could potentially have opportunities to appropriate public funds or take bribes, or their family members or close associates). For high risk PEPs, the burden of proof should be flipped, so that such customers have to prove that their funds are legitimate, rather than allow banks to simply find a plausible explanation for a customer's wealth. At the moment if banks can find a slightly plausible explanation for the source of funds (e.g. unverified claims of a substantial inheritance) they can take it.

Finally, the **Financial Action Task Force** should use its new focus on whether countries are effectively implementing its standards to put pressure on countries that are not doing enough to tackle money laundering and corruption. One way of starting the ball rolling on this would be for all mutual evaluations, which are often hundreds of pages long, to include a summary with the various recommendations put in order of priority.

Photo: Todd Wickersty / CC

It can be easier to set up anonymous companies in G8 countries such as the US and UK than in more traditional 'offshore' centres such as the Cayman Islands.

Conclusion

"A lack of knowledge about who ultimately controls, owns and profits from companies leads to aggressive tax avoidance, tax evasion and money laundering, undermining tax bases and fuelling corruption across the world. Therefore, the G8 and EU must work together to ensure full transparency in beneficial ownership."

Prime Minister David Cameron, April 2013[39]

There is a growing awareness of how the lack of transparency over who owns and controls companies, trusts and other corporate vehicles aids corruption and tax evasion. There is also a growing movement to increase the transparency over who owns and controls corporate vehicles. In particular, the UK Prime Minister has announced that he hopes to use the country's presidency of the G8 to improve company ownership transparency. The US government has committed to ensuring greater transparency over the beneficial ownership of US companies, via the commitments made to the Open Government Partnership (OGP), and, from 2016, the Extractive Industries Transparency Initiative will require natural resource companies bidding for licenses to declare the names of their beneficial owners. The time to act on this is now.

Recommendations

How to stop the abuse of anonymous companies

- Countries should require companies, trusts and foundations to put information about their beneficial owner(s) in the public domain, available for free, in open data format.

- Countries should put pressure on the secrecy jurisdictions with which they have relationships to adopt a similar standard.

How to stop banks taking money from corrupt politicians

- Hold senior bankers individually responsible for the actions of their institutions, including:

  - making a board member responsible for a bank's compliance with the anti-money laundering laws

  - tying bankers' remuneration to how 'compliant' a bank is, including by clawing back bonuses if the bank is found to have been complicit in laundering money

  - preventing senior individuals from working in the industry where laws have been breached

  - putting senior bankers in the dock in the most egregious cases.

- Increase the sanctions imposed on banks that break the law. The starting point should be that if a bank has committed serious breaches of the rules it should lose all the revenue it made from its illegal activity plus be faced with an extra penalty as a deterrence.

- Require regulators to carry out mystery shopping exercises and spot checks.

- Flip the burden of proof such that high risk customers have to prove that their funds are legitimate rather than allow the banks to find a plausible explanation for a customer's wealth.

- Ensure that the Financial Action Task Force puts pressure on countries that are not doing enough to tackle money laundering and corruption.

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