This document is distributed as an annex to the Status Report on the Five Issues Relating to Corruption (DAFFE/IME/BR(2000)24), which is for discussion at the meeting of the Working Group on 4-5 October 2000 under agenda item 7.
Report on the Misuse of Corporate Vehicles for Illicit Purposes

Preliminary Outline
4 September 2000

I. 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. Earlier this year, the Financial Stability Forum 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 has noted the role of corporate vehicles in money laundering schemes. Similarly, the OECD Working Group on Bribery in International Business Transactions has found that the misuse of corporate vehicles in offshore financial centres 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. Because of the potential for abuse of today’s open and global financial system, which could result in the misallocation of resources and systemic risk, the issue of the misuse of corporate vehicles for illicit purposes has come to the forefront of policy makers’ agendas.

Following a request by the Financial Stability Forum, 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 announced that the OECD would conduct analytical work on the misuse of corporate entities. At their recent meeting in Okinawa, 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. 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.

II. Introduction

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 activities and they facilitate the entrepreneurial activities that underlie market-based economies. However, corporate vehicles of all forms can be misused for a variety of illicit purposes, including money laundering, bribery, concealing financial losses, improper insider dealings, and other forms of illicit behaviour. Using corporate vehicles as conduits to perpetrate such abuses is potentially appealing because these vehicles enable the perpetrators to cloak their malfeasance behind the veil of a separate legal entity. When illicit activity is suspected, however, the authorities in many jurisdictions have the capacity, through court-issued subpoenas and other measures, to penetrate the legal entity in order to identify the beneficial owners. Another means used to deter the misuse of corporate vehicles is to require extensive disclosure of ownership and control at the initial formation
and/or share issuance stages and to make such information available to authorities when illicit activity is suspected.

Certain jurisdictions, however, offer a high level of anonymity by enacting secrecy laws that prohibit company registrars, financial institutions, lawyers, accountants, and others, under the threat of administrative and criminal sanctions, from disclosing any information regarding beneficial ownership. Some of these jurisdictions further protect anonymity by allowing corporate vehicles incorporated or established in their jurisdictions to use instruments that obscure beneficial ownership and control, such as bearer shares, nominee shareholders, and nominee directors, without devising mechanisms that would enable authorities to identify the true owners when illicit activity is suspected.

In order to effectively combat and prevent the misuse of corporate vehicles, it is essential that the authorities have the capacity to obtain, on a timely basis, information about the beneficial ownership and control of corporate vehicles. This may be achieved through a range of options, based on the specific situation in each jurisdiction. Because anonymity is often enhanced through the use of corporate vehicles incorporated in foreign jurisdictions, it is equally critical that domestic and international authorities also have the ability to share information on beneficial ownership and control with each other. It is important to stress that authorities must be empowered to obtain and share such information on a timely basis as delays will give the perpetrators time to erect an additional layer of anonymity in yet another jurisdiction.

III. Outline – Part I: Extent and Means of Misuse of Corporate Vehicles for Illicit Purposes

(A) Part I of the Report will examine the types of corporate vehicles that are being misused for illicit purposes. In this Report, the term “corporate vehicles” has been defined to include corporations, trusts, limited liability partnerships, special purpose vehicles, and other entities with limited liability and a separate legal personality from their founders or owners. As discussed above, the critical factor in misusing corporate vehicles is the potential for anonymity. Not surprisingly, the corporate vehicles that are misused most frequently are those that provide the greatest degree of anonymity, such as international business corporations (IBCs), exempt companies, and trusts incorporated or established in jurisdictions that offer a high-degree of secrecy and/or which do not require disclosure of beneficial ownership. In some offshore financial centres (OFCs), certain types of corporate vehicles, such as IBCs, can be established instantly and for as little as US$150.

1 It is important to note that perpetrators often use groups of corporate vehicles, each established in a different high-secrecy jurisdiction, to enhance anonymity and to frustrate any investigation by authorities.
2 The purpose of Part I of the Report is not to provide an exhaustive account regarding the misuses of corporate vehicles for illicit purposes. Rather, the Report will analyse misuses of corporate vehicles that are generally recognised as the most pernicious to the financial system.
3 According to the April 2000 Report of the Financial Stability Forum Working Group on Offshore Financial Centres, international business corporations (IBCs) are limited liability entities incorporated in an offshore financial centre (OFC) and may be used to own and operate businesses, issue share or bonds, or raise capital in other ways. In many OFCs, IBCs may be established instantly and for a minimal cost and are generally exempt from all taxes. In certain OFCs, nominee directors may be used and IBCs are permitted to issue bearer shares.
4 The 1998-1999 Financial Action Task Force Money Laundering Typologies report noted that problems in obtaining information from certain jurisdictions on the beneficial owners of shell companies, IBCs, and offshore trusts were the primary obstacle in investigating transnational laundering activities.
(B) The Report will also examine the means through which anonymity is achieved. These include the utilisation of bearer shares, nominee directors/shareholders, and intermediaries such as lawyers (and other professionals), who provide an additional layer of secrecy through their attorney-client privilege.

(C) The Report will examine to what ends corporate vehicles have been misused, using case examples where appropriate. Examples in which the Internet is involved in the misuse of corporate vehicles may also be discussed. A brief description of the main types of misuses of corporate vehicles is provided below:

- **Money laundering:** Money launderers misuse corporate vehicles to disguise the true origin and beneficial ownership of ill-gotten gains. To this end, launderers often establish shell companies, trusts, or partnerships in multiple jurisdictions, building layers of ownership to impede discovery of their true identity and imitating legitimate business transactions to hide the source of ill-gotten gains. In certain instances, the use of these vehicles can also frustrate financial institutions’ efforts to comply with applicable anti-money laundering laws requiring them to ascertain the identity of their account holders.

- **Bribery:** To establish a slush fund that can then be used for bribery, transfers of funds may be accomplished through the use of fake invoices (i.e., for services) issued by a company established in a high-secrecy jurisdiction where beneficial ownership cannot be divulged or is not required for the company’s incorporation. Correspondingly, the corrupt official can establish dummy accounts, in the name of shell companies, to receive funds from the company paying the bribe.

- **Hiding assets from creditors:** In certain bankruptcy cases involving individuals, funds have been siphoned out of one jurisdiction through companies and trusts incorporated in other jurisdictions where it was extremely difficult to trace beneficial ownership. To further ensure anonymity, the perpetrator may find it advantageous to deposit funds in an account opened in the name of a corporation that can issue bearer shares. Recently, certain jurisdictions have created new types of trusts, commonly known as asset protection trusts, that greatly enhance the ability of individuals to move assets out of the reach of creditors in their home jurisdictions.

- **Illicit tax practices:** The anonymity provided by corporate vehicles established in certain jurisdictions can also serve to facilitate illicit tax practices. In certain high-secrecy jurisdictions, beneficial ownership and control information may be concealed through the use of secrecy laws, bearer shares, nominee shareholders, and intermediaries such as company formation agents. The use of corporate vehicles in these high-secrecy jurisdictions may facilitate unlawful transfer pricing and other tax practices by making it more difficult for tax authorities to obtain accurate information.

- **Self-dealing/defrauding assets:** The anonymity provided by corporate vehicles incorporated in certain jurisdictions may provide a facade of legitimacy (i.e., arm’s length dealing) to an otherwise improper transaction between related parties in a corporation. In one instance, the management of an oil company announced that it would issue millions of new shares, at a deep discount to the then-prevailing market price, to a series of anonymous companies incorporated in a high-secrecy jurisdiction. In another instance, the same oil company approved the sale of oil to a series of offshore companies at one-tenth the market price.

- **Concealment of financial losses:** In part due to the absence of consolidated accounting and reporting in their home jurisdictions, corporations and corporate groups have been able to hide financial losses by shifting assets to corporate vehicles incorporated offshore, beyond the scrutiny of domestic regulators and auditors.
• **Market fraud and circumvention of disclosure requirements:** Insiders of publicly-listed corporations have been able to abuse their access to material, non-public information by using corporations incorporated in foreign jurisdictions to carry out illicit buying and selling of shares. In addition, individuals have been able to use the anonymity of certain corporate vehicles to hide their control of entities that are being used to manipulate the market for publicly traded securities. For example, 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.

IV. Outline – Part II: Obtaining and Sharing Information on Beneficial Ownership and Control

(A) Part II of the Report will first examine the existing impediments to obtaining and sharing information on beneficial ownership and control. Some of the issues that impact the ability of authorities to obtain and share information on beneficial ownership and control are described below:

• **Corporate secrecy law:** A number of jurisdictions have enacted corporate secrecy laws that prohibit, under the threat of administrative and criminal sanctions, disclosure of the beneficial ownership and control of corporate vehicles even when illicit activity is suspected. Such a high level of secrecy may serve to effectively thwart all efforts at obtaining and sharing beneficial ownership and control information.

• **Company law and other related laws:** Company law is highly relevant because it regulates the availability of bearer shares, the use of nominee directors/shareholders, the requirements for establishing a registered office, and the keeping of shareholders’ registers. Other related laws are also relevant for obtaining information on beneficial ownership and control. For example, trust law is relevant because it regulates such issues as the duration of trusts, the restrictions on trust instruments, obligations of trustees, and identification requirements. In addition, anti-money laundering laws that require financial institutions to “know their customers” may also assist authorities to obtain beneficial ownership and control information. A country’s company law and other related laws, depending on their particular features, may therefore aid or impede the efforts of authorities to obtain information on beneficial ownership and control.

• **Role of company formation agents, accountants, and lawyers:** In certain jurisdictions, company formation agents, accountants, and lawyers play a role in devising schemes to ensure anonymity for their clients and in establishing and managing IBCs, exempt companies, trusts, special purpose vehicles, and other corporate vehicles. In some jurisdictions, such intermediaries are not required to reveal their client’s identity and need only declare that they have ascertained the identity of the beneficial owner. Furthermore, lawyers in these jurisdictions may also able to invoke the attorney-client privilege in order not to be compelled to divulge beneficial ownership, even when they are acting in a business capacity rather than a legal capacity. Additionally, these persons are often the only ones who have knowledge about the beneficial owner.

• **Legal system, institutional infrastructure, and the availability of financial and human resources:** It is evident that a country’s legal system, institutional infrastructure, and availability of financial and human resources are relevant in assessing the capacity of authorities to obtain and share information on beneficial ownership and control. In certain jurisdictions, government agencies charged with oversight of the corporate and financial sectors are drastically underfunded and understaffed and have weak enforcement powers. For example, supervisors in some countries lack the ability to obtain information and documents, including information about the beneficial owner.
ownership and control of corporate vehicles, from entities located or operating in their jurisdictions.

In addition, in some countries, impediments exist regarding the sharing of information with other authorities domestically and internationally. Moreover, the capacity of their court systems to identify beneficial owners in a timely fashion may be constrained by institutional weaknesses. On the other hand, other jurisdictions have a long history of committing the resources necessary to obtain and share information on beneficial ownership and control.

(B) Subsequently, the Report will survey existing mechanisms that have been adopted by countries to obtain information on beneficial ownership and control. The Report will also identify the factors that may have influenced a country’s choice of a particular mechanism, such as the nature of business activity in the country, the extent of non-resident ownership, the availability of financial and human resources, and the powers of domestic authorities to obtain information. For example, jurisdictions that have decided to require extensive, up-front disclosure of beneficial ownership and control and detailed reporting of transactions may have done so because of a high-degree of non-resident corporate ownership, regulators with weak compulsory powers, and limited resources devoted to financial law enforcement.

(C) Similarly, the Report will analyse the mechanisms available to share beneficial ownership and control information among domestic and international authorities. The Report will also examine whether existing systems that are being utilised for related purposes, such as financial intelligence units (FIUs) that collect and share money laundering information, have also been used to share beneficial ownership and control information. The Report may also consider the role of financial institutions in gathering information on beneficial ownership and control of corporate vehicles that have their accounts with them.

V. Outline – Part III: Menu of Possible Options for Obtaining and Sharing Beneficial Ownership and Control Information

(A) In view of the analysis and results in Parts I and II of the Report, Part III of the Report will develop a menu of possible options to facilitate the capacity of authorities to obtain, on a timely basis, information about the beneficial ownership and control of corporate vehicles, and the ability to share this information, domestically and internationally, with authorities and others appointed by or acting under the supervision of the government, such as insolvency administrators.

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