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Corporate Vehicles and Illicit Finance

- Policy Recommendations

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Introduction

How are “corporate vehicles” (like companies, trusts and partnerships) misused by criminals and other unethical people to control, conceal and convert their illicit finances?

This was the subject of investigation by Dr Nicholas Lord (University of Manchester), Professor Liz Campbell (Monash University) and Dr Karin van Wingerde (Erasmus University Rotterdam) in a two-year research project (2016-18) funded by the Partnership for Conflict, Crime & Security Research (PaCCS) and supported by project partners Police Scotland and Ciroc (the Centre for Information & Research on Organised Crime) in the Netherlands.

Those involved in serious crimes for gain need to manage their illicit finances, avoiding detection by regulators and law enforcement agencies. They want to obscure the source of their illicit finances and hide their criminal identity. One way to do this is by using “corporate vehicles”.

The term “corporate vehicle” refers to legal structures such as trusts, foundations, limited partnerships and companies. Such vehicles provide a range of commercial activities including the control and movement of wealth and assets in the financial system. For instance, they permit businesses to incorporate companies in low or no tax regimes, provide flexibility in global markets, and reduce the level of regulation, particularly when set up in jurisdictions that offer great confidentiality. Large flows of monies move through the global financial system in this way and this has become a central feature of business in market-based economies.

Such corporate vehicles provide opportunities for those involved in serious crimes for gain to manage their illicit finances. This misuse of corporate vehicles came to prominence in the 2016 leak of 11.5 million files at the centre of the Panama Papers scandal, as well as the Paradise Papers leak in 2017. The Papers illustrated how such legal structures are being misused and abused for illicit and illegitimate purposes, such as the evasion and avoidance of tax by wealthy individuals, the concealment of corrupt funds by public officials, and money laundering, amongst
others. These issues have come to the fore globally, but also in the UK specifically as the financial system has been implicated in facilitating the hiding of illicit wealth and assets totalling more than £100bn via corporate vehicles, in particular into the property market (Transparency International, 2018).

Core Findings

Our research has evidenced that corporate vehicles create an illusion of legitimacy through the abuse of otherwise lawful business arrangements, provide effective anonymity for the owners of illicit assets and insulation from enforcement, particularly when organised across jurisdictions with favourable features, and that there is a necessity for third-party professionals who operate within a stratified market to facilitate their misuse (Lord et al., 2018). In all cases we come across, corporate vehicles provide opportunities for managing illicit finances that individuals alone cannot access, but which require some element of third-party collaboration and facilitation.

The professional intermediaries facilitating corporate vehicle misuse are Company Formation Agents (CFAs), Trust & Company Service Providers (TCSPs) or other agents who set-up and manage corporate vehicles on behalf of others. These are usually legitimate service-providers, such as accountants, lawyers, notaries, or specialists in company formation. Little is known about the motivations of those professionals who assist criminal enterprise in this way, but some form of collusion or assistance from them - whether witting or unwitting (or wilfully blind) - is usually required. Furthermore, a stratified market exists for professional intermediaries that can service the management of illicit finances, and this consists of (Lord et al., 2019):

- **Actors and Providers:** This includes a range of professional actors/providers with cognate expertise operating in different market segments and with capacity for corporate vehicle formation defined by clientele, access, advertising and available products/services. For example, at the premium end are elite TCSPs, and top law firms, that do not normally advertise and are difficult to access publicly, or have such a high price range they are difficult to enter.
Connections are made through social/business networks. At the economy end an abundance of online TCSPs provide a range of products and services; anyone can access these, though language barriers can exist.

- **Commodities/products:** This includes different types of corporate vehicles (i.e. goods/products) of varying assigned value determined by features/specifications offered e.g. history, legal characteristics and jurisdictional location. For example, there is a premium placed on those vehicles with a recorded history and data as this provides an appearance of legitimacy when such vehicles are subsequently misused. For instance, the longer the VAT history and company data on record, the more valuable the vehicle can be.

- **Services:** This includes a range of different types of service over time (i.e. as one-off or continuing arrangements) with level/extent of service, duration and nature (i.e. product or assistance also). For example, services can include set-up and registration (e.g. with Companies House in the UK), through to the annual submission of accounts on behalf of the clients. Such companies may also provide fund management, regulatory compliance and ‘registered office’ services (i.e. addresses at which multiple, sometimes tens of thousands, corporate vehicles are registered).

‘The intermediaries, they’re the key…the weak link…whether they’re lawyers, accountants or professional company secretaries…They’re the key to mitigating measures and they’re the key to regulation.’

- Intergovernmental AML Authority Actor

The structure of, and changes in, these markets and the actors, products and services are shaped and driven by:

- **Supply** (of different products and services across different jurisdictions)
- **Demand** (by actual and potential clients of varying type, and with different intentions/purposes in mind)
- **Competition** (between and within jurisdictions and between different formation agents operating in within varying segments of the market; secrecy wars)
Regulation (presence and competence of capable guardians; legal asymmetries and lacunae that shift supply/demand/competition dynamics)

Our research demonstrates the misappropriation of otherwise legal markets and constructs as facilitators of crime. Furthermore, it reinforces, as with much white-collar, corporate and organised crime scholarship, the ambiguities that exist within legitimate spheres, the blurred interfaces between the licit and illicit, and the social harms that can arise from otherwise lawful financial structures and arrangements. A difficulty in researching the misuse of corporate vehicles is the lack of valid, systematic data and sources on misuse, meaning the extent of professional misconduct is unknown or unproven (Middleton and Levi, 2015). Cases that led to convictions of professionals for facilitating money laundering rarely involved corporate vehicles (Benson, forthcoming), implying many high-level money laundering cases are going unprosecuted. It is clear that the misuse of corporate vehicles is a serious issue, impacting on the functioning of financial systems and market integrity, and generating social harms across society.

Key Policy Recommendations

This Policy Brief draws on and summarises our key findings and recommends responses to the misuse of corporate vehicles. The UK Government recognises the need for corporate vehicle misuse to be addressed (HM Treasury/Home Office, 2017), and corporate vehicle misuse was also highlighted in the Financial Action Task Force’s (FATF) evaluation of the UK’s anti-money laundering measures (FATF, 2018). In policy terms, it is clear that a plausible route to minimising misuse is to focus on i. professional intermediaries by improving the regulation and supervision of third-party professionals to reduce opportunities for misuse by their clients, and ii. tightening laws and regulations on how and where corporate vehicles can be created. In these terms, our research has identified a series of short-term, medium-term and long-term policy changes that could significantly reduce corporate vehicle misuse in the UK:

Short-term:

- **Raising awareness about the nature and seriousness of corporate vehicle misuse:** Following major data leaks relating to corporate vehicles, attention has been placed on reducing their misuse in the UK and the Netherlands by civil society and law enforcement authorities, but to a lesser extent in the US and Asia. However, awareness as to the nature (e.g. the role of ‘legitimate’ actors) and seriousness (e.g. market distortion) of corporate vehicle misuse needs to be raised, particularly within political spheres, as governments seek to protect economic interests whilst also appeasing pressure to respond. Due to these tensions, there is a lack of urgency to create regulations that reduce the scope for these structures and vehicles to be misused.

- **Randomised enforcement/supervision trials:** There are over 20 authorities/bodies in the UK with supervisory/regulatory responsibilities for corporate vehicles and formation agents, including HMRC, the Law Society (of Scotland and Northern Ireland) / Solicitors Regulation Authority, Insolvency Practitioners Association, Financial Conduct Authority (hosting the Office
for Professional Body Anti-Money Laundering Supervision (OPBAS)), plus more. The sheer number of vehicles and agents undermines enforcement efforts, given austere budgets and inconsistent and fragmented responses. We advocate randomised enforcement operations and ‘dip tests’ that would target particular sectors or industries, followed by systematic evaluation of the intervention effects to provide valid ‘before and after’ data for evidence based policies.

**Medium-term:**

- **Creation of a UK Screening Authority:** A sufficiently resourced centralised authority with scope to regulate company registration data (including foreign ownership) and undertake due diligence on the creation of all vehicles, as we see in the Netherlands with the Judicial agency for Testing, Integrity and Screening under the Ministry of Justice and Security which is responsible for assessing the reliability of people and organisations. This authority is also responsible for so-called ‘BIBOB’ screenings: this relates to the Dutch Public Administration (Probity Screening) Act that aims to prevent authorities from engaging in transactions with mala fide parties. Various activities requiring a permit fall under the scope of BIBOB, and permits can be refused or revoked based on the BIBOB assessment. In the interim period, this might also take the form of an independent multi-agency task force.

- **Only licensed and/or regulated agents to be able to form UK corporate vehicles:** The market for formation agents and service providers is stratified, diverse and global. Ensuring only licensed and regulated agents can form vehicles will improve the validity of registration data, ensure due diligence of client wealth, and minimise misuse by foreign agents. We are aware that such initiatives are underway in the UK (e.g. in relation to Scottish Limited Partnerships) but there must be sufficient resources and mechanisms for enforcing this and they must apply to all forms of corporate vehicle.

**Long-term:**

- **Legislative change for the support of public-private data sharing for regulation, policing and research:** Private sector organisations are well-placed in terms of bulk data on corporate vehicle usage; we strongly recommend improved measures to facilitate data sharing, within reason and complying with human rights/GDPR, between public and private organisations in order to inform intervention with, and reduction of, corporate vehicle misuse. Similarly, as with the Netherlands and Germany, where there are legal obligations for state authorities to support scientific investigation, we advocate mandatory legal requirements in the UK for the sharing of relevant data by state agencies for the purposes of scientific, academic research.

- **Formal periodic reviews of strategy and operation:** Currently, there are multiple strategies that incorporate aspects of corporate vehicles (e.g. Serious and Organised Crime Strategy; Anti-Corruption Strategy) but there is no public or systematic evaluation over time of how these strategies have been implemented and operationalised, and the impact they have had. Such evaluation ought to be central to policy learning and ensuring accountability. Systematic and transparent scrutiny and evaluation of stated governmental objectives and goals should be carried out on a regular and independent basis to measure progress over time.
The Project
The (Mis)Use of Corporate Vehicles by Transnational Organised Crime Groups in the Concealment, Conversion and Control of Illicit Finance is led by Dr Nicholas Lord (University of Manchester). The research developed (i) a comprehensive understanding of how, why and under which conditions transnational organised crime groups use corporate vehicles for the concealment, conversion and control of illicit finance in the UK and the Netherlands and associated patterns, trends, features and impacts of these activities, and (ii) a concise analysis of legal, enforcement and policy conditions that govern the creation and use of corporate vehicles for illicit finance in addition to the extent of legal/criminogenic asymmetries across the EU.

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References