

# **TYPOLOGIES PAPER ON MONEY LAUNDERING & TERRORISM FINANCING (ML/TF) TECHNIQUES TO MISUSE LEGAL PERSONS AND LEGAL ARRANGEMENTS (LPLAs)**

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**Acronyms / Terms**

AML/CFT	Anti-Money Laundering / Counter Financing Terrorism
AML Act 2010	Anti-Money Laundering Act, 2010
APG	Asia Pacific Group on Money Laundering
ATA 1997	Anti-Terrorism Act, 1997
CDD/KYC	Customer Due Diligence / Know Your Customer
CTD	Counter Terrorism Department
DNFBPs	Designated Non-Financial Businesses and Professions
FATF	Financial Action Task Force
FBR	Federal Board of Revenue
FIA	Federal Investigation Agency
FIU	Financial Investigation Unit
FMU	Financial Monitoring Unit of Pakistan
LEA	Law Enforcement Agencies
LLP	Limited Liability Partnership
MER 2019	Mutual Evaluation Report 2019
ML	Money Laundering
NRA	National Risk Assessment
NPOs	Not for Profit Organizations
PF	Proliferation Financing
SECP	Securities and Exchange Commission of Pakistan
SBP	State Bank of Pakistan
TF	Terrorism Financing
Typologies	In the AML/CFT context, the term “typologies” refers to the various techniques or methods used to launder money or to finance terrorism
TCSP	Trust and Company Service Provider
TOs	Terrorist Organizations
UBO	Ultimate Beneficial Owner
UN	United Nations
UNSCR	UN Security Council Resolution

## Executive Summary

Legal persons and legal arrangements, because of their inherent nature, are vulnerable to being used by criminals to hide ownership. The purpose of these typologies is to inform regulated entities and other stakeholders as to how legal persons and legal arrangements can be abused for money laundering and terrorist financing purposes.

Concealment of beneficial ownership is a key means by which legal persons and arrangements are abused for MLTF purposes. The key methods utilized to conceal beneficial ownership can be divided into three extensive categories:

- i. producing complex possession and control structures using legal persons;
- ii. utilizing nominees and professional intermediaries to cloud the relationship between the beneficial owner and assets; and
- iii. Falsifying activities using bogus invoices, false loans, and misleading naming conventions.

The typologies in this paper have been taken from case studies found both within Pakistan and internationally. They provide examples for relevant stakeholders to assist them in identifying fact patterns and circumstances that may be indicative of illicit financial activity. However, these typologies do not provide an exhaustive list of such circumstances, and stakeholders should continue to assess customer risk and identify suspicious transactions in accordance with their legislative and regulatory obligations.

This document needs to be understood in conjunction with the risk assessment for LPLA undertaken in NRA 2019 along with Sectoral Risk Assessment (“SRA”) specific to legal persons and legal arrangements carried out in Feb 2021. These risk assessments were conducted in light of guidance by FATF from time to time with respect to Beneficial Ownership and Transparency. Outline of Sectoral Risk Assessment covers all areas including Types of LPLAs, geographical spread, ML/TF risk characteristics and information gaps. To further assist readers, frequently asked questions (FAQs) on SRA for LPLA 2021 are available on SECP’s website.<sup>1</sup>

## Objective

The Legal Persons and Legal Arrangement Working Group (WG) comprising of officers from AML Department of SECP and Ministry of Interior has prepared this typologies paper, with the objective of informing regulated entities and other stakeholders about:

- ▶ Profile of Legal Persons and Legal Arrangements active in Pakistan;
- ▶ Typologies and case studies on the misuse of Legal Persons observed in Pakistan and other jurisdictions;
- ▶ identifying fact patterns and circumstances that may be indicative of illicit financial activity;
- ▶ Red flag indicators on the misuse of legal persons and legal arrangements for money laundering and terrorist financing purposes.
- ▶ Recommendations to improve the detection of the misuse of Legal Persons;

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<sup>1</sup> <https://www.secp.gov.pk/document/faqs-on-sectoral-risk-assessment-of-legal-person-legal-arrangements-lpla/?wpdmdl=42008&refresh=6107dceb6cf411627905259>

## Introduction

FATF Recommendations 24 and 25 require that legal persons and arrangements are prevented from misuse for money laundering or terrorist financing and that information on their beneficial ownership is available to competent authorities without impediments.

Legal persons and legal arrangements, because of their inherent nature are used by criminals to hide ownership. Methods used include the utilization of shell, shelf, and front organizations, development of complex chains of proprietorship and division of resources and governance across countries. In addition, the use of nominee directors, shareholders, and beneficiaries (both formal and informal) greatly increases the risks by creating barriers between the natural person, the ultimate beneficial owner (UBO) and criminal proceeds. In many cases, professional intermediaries such as lawyers and accountants play an important role in helping create and operate the structures used to conceal the activities and beneficial ownership of criminals, either through complicity or unwittingly.

In Pakistan, there are various types of legal persons and legal arrangements. Legal persons include companies and limited liability partnerships (LLPs), which are formed federally and cooperative societies that are formed under provincial and territorial legislation. Legal arrangements include trusts and waqfs, which are formed under provincial and territorial legislation. Legal persons and arrangements play an important and essential role in supporting commercial and entrepreneurial activity. However, under certain conditions, they may end up being misused for illicit purposes, including money laundering (ML), bribery and corruption, insider dealings, tax fraud, and terrorist financing (TF) etc. To counter their misuse, effective AML/CFT measures are needed.

## Overview of Risk at National Level

Since 2015, Pakistan has reviewed and updated its understanding of risk at regular intervals. This includes extensive assessments of ML / TF at national levels and focused studies of the sectoral risks. An initial assessment of risks relating to LPLA was undertaken in the National Risk Assessment (NRA) 2019. The results of NRA 2019 supported a comprehensive self-assessment of Pakistan's compliance with the FATF standards, with respect to Recommendations 24 (Legal persons) and 25 (Legal arrangements). As a result of this self-assessment, Pakistan identified gaps in its framework and identified measures to mitigate these risks, including through legislative and regulatory changes and new administrative measures.

Oversight activities carried out after the introduction of legislative and regulatory changes in September 2020 informed an improved understanding of inherent vulnerabilities for legal persons and arrangements in greater and more accurate detail. This has allowed Pakistan to revisit the vulnerability levels of certain types of entities for re-rating.

At the national level a large proportion of the regulated LPLA sector comprises of small size entities, limited types of LPLAs and a very domestic nature of the business activities. Accordingly, keeping in view the much-improved legal framework for both LPs and LAs, the vulnerability levels for ML/TF for the LPLA sector are stable. The next risk assessment of LPLAs is scheduled to take place in 2022 ,as part of the overall update to the National Risk Assessment.

## 1. Legal Persons

### What is a legal person?

Legal person refers to any entities other than natural persons that can establish a permanent customer relationship with a financial institution or otherwise own property. This can include companies, bodies corporate, foundations, anstalt (institution), partnerships, or associations and other relevantly similar entities. *Source: Glossary of the Recommendations FATF*

### Types of Legal Persons

In Pakistan, legal persons take the form of companies, limited liability partnerships and cooperative societies registered under their respective federal or provincial laws. To help you understand the case studies and typologies provided, a brief summary of the different types of persons and legal arrangements follows:

#### I. Companies

A company may be formed domestically within Pakistan pursuant to and be regulated under the Companies Act, 2017. Such companies may include:

- (i) Single Member Limited Companies;
- (ii) Private companies (two or more associated persons);
- (iii) Public companies (also referred to as listed companies);
- (iv) Public interest companies;
- (v) Public sector companies;
- (vi) Companies limited by guarantee;
- (vii) Associations (formed as charities and not for profit companies).

Foreign companies may also be operating in Pakistan. Such companies are formed under the Companies Act 2017, and are defined as any company or body corporate incorporated outside Pakistan that has a place of business or liaison office in Pakistan, or which conducts any business activity in Pakistan through any other manner.

#### II. Limited Liability Partnerships

Limited liability partnerships are formed under the LLP Act 2017, and allow for a new form of business structure aimed at filling the gap between business firms such as sole proprietorships/partners whose liability is unlimited, and the companies governed under the Companies Act 2017, whose members enjoy the benefits of limited liability.

The LLP provides an alternative form of business organization, which has the flexibility of a general partnership, while availing all the advantages of a limited liability company. LLP Act 2017 allows formation of two types of LLPs: domestic LLP and foreign LLP.

#### III. Cooperative Societies

The Cooperative Societies are regulated in the Provinces and in the Islamabad Capital Territory under the respective provincial Cooperative Societies Act 1925, and Cooperative Societies Rules, 1927. The societies that have higher number of memberships or high working capital such as credit or housing societies may be vulnerable to risk. In case of a cooperative society with a large membership, a proscribed person can hide their identity and invest illegal money as a member.

There are mainly three types of Cooperative Societies: Primary Level Societies, Secondary Level Societies and the Apex Level Societies. Primary level societies have natural persons as their

members with a minimum of 10 members required for registration of the society, and there is no restriction on maximum number of members in the society. It may be noted that the structure of apex and secondary level societies is the same. Both have societies as their members and there is no upper and lower restriction on membership.

## **2. Legal Arrangements**

### **What is a legal arrangement?**

Legal arrangement refers to express trusts or other similar legal arrangements. Examples of other similar arrangements (for AML/CFT purposes) include fiducie, treuhand and fideicomiso.

Source: Glossary of the FATF Recommendations

Legal arrangements in Pakistan include trusts and waqfs which are registered and regulated under provincial laws. In Pakistan, legal persons and legal arrangements can be registered quite easily after meeting basic initial requirements, and can undertake a variety of commercial and business activities. To help you understand the case studies and methodologies provided, a brief discussion of the different types of legal persons and legal arrangements is as follows:

#### **I. Trusts**

A trust is a legal arrangement under which a person, the settlor, places assets under the control of a trustee for the benefit of a beneficiary or for a specified purpose. Trusts are regulated at the provincial level and in the Islamabad Capital Territory by the respective provincial Trust Act and associated rules.

#### **II. Waqfs**

Waqfs are administered at the provincial level and in the Islamabad Capital Territory under respective laws by Auqaf Departments. Each province and territory have separate legislation/ rules etc. to manage and control Waqf properties in their respective area of jurisdiction. Waqf property is defined as “property of any kind permanently dedicated by a person professing Islam for any purpose recognized by Islam as religious, pious or charitable....”

The two special territories of GB and AJK have adopted the relevant federal and provincial legislative frameworks with respect to legal persons and legal arrangements.

## **3. Techniques for misuse of Legal Persons and Legal Arrangements**

These techniques, along with the relevant case studies, are aggregated to inform an improved understanding of how legal persons and legal arrangements may be exploited for money laundering and terrorism financing.

Concealment of beneficial ownership is a key means by which legal persons and arrangements are abused for ML and TF purposes. The methods utilized to conceal beneficial ownership can include:

- i. producing complex possession and control structures using legal persons, especially when set up across various jurisdictions;
- ii. utilizing people and monetary instruments to cloud the relationship between the beneficial owner and assets, including nominees and professional intermediaries; and
- iii. Falsifying activities using bogus invoices, false loans, and misleading naming conventions.



Legal persons and arrangements may also be used as shell companies, shelf companies, or front companies or arrangements to disguise and obscure illicit financial activity.

The negative aspect of legal arrangements is that they can be misused by criminals and terrorist organizations for money laundering or terrorism financing, for example by:

- (i) By posing as legitimate entities;
- (ii) By exploiting legitimate entities as conduits for ML and TF, including for the purpose of evading asset freezing measures.

The enhanced anonymity offered by trusts and trust-like legal arrangements can provide significant benefits to a criminal operation. The ability to separate legal ownership from beneficial ownership presents a range of challenges for authorities and service providers seeking to determine beneficial ownership. However, it can also pose a number of risks to the criminals who utilise them making them less attractive to criminals. Legal arrangements require the criminals to relinquish legal ownership and control of the asset to a trustee to manage the benefit (or title) of the asset. The introduction of a trustee may pose a vulnerability to the criminal operation, for instance if the trustee is not complicit, or if control over the trustee is not guaranteed.

FMU has developed Red Flag Indicators for both legal persons and legal arrangements to assist reporting entities to identify suspicious transactions. These can be accessed at:

- [https://www.fmu.gov.pk/docs/Red\\_Flag\\_Indicators\\_for\\_Misuse\\_of\\_Legal\\_Persons.pdf](https://www.fmu.gov.pk/docs/Red_Flag_Indicators_for_Misuse_of_Legal_Persons.pdf); and
- [https://www.fmu.gov.pk/docs/Red\\_Flag\\_Indicators\\_for\\_Misuse\\_of\\_Legal\\_Arrangements\\_and\\_NPOs.pdf](https://www.fmu.gov.pk/docs/Red_Flag_Indicators_for_Misuse_of_Legal_Arrangements_and_NPOs.pdf).

## 4. Data Collection

Both international and domestic sources of information have been used in developing these typologies.

International sources include FATF Recommendations and publications on legal persons and arrangements, as well as FATF and FATF-style regional body annual typology reports.

Domestic sources include:

- Enforcement actions leading to investigation and prosecution.
- Complaints by regulated entities, customers general public with respect to illegal activities

## 5. Case studies

The following case studies obtained from FATF typologies reports and other FATF publications relate to old cases, and where relevant, such entities have already been proscribed and banned by the concerned authorities. These are being presented to demonstrate the abuse of legal persons and arrangements for money laundering and terrorist financing purposes by criminals.

### 1.1 Use of Complex Ownership and Control Structures

Complex ownership structures are the primary method of concealing beneficial ownership for money laundering purposes. These intricate structures are developed by creating layers of

possession that involve various legal persons across numerous jurisdictions, disassociating the beneficial owner from the assets owned by the corporation. Commonly, intermediaries are used by the beneficial owners to retain control of a complex structure. Legal persons are permitted to possess shares in companies set up in any country and many countries allow legal persons to be enlisted as directors of organizations. In this regard, shell organizations and front organizations are a common component in most complex structures recognized by FIUs.

These structures can be utilized to cloud beneficial ownership, evade tax collection commitments, disguise wealth, and wash criminal proceeds. Complex structures are utilized in fake investment plans, phony company activity, bogus invoicing, and different kinds of fraudulent activities. The utilization of various legal persons inside an individual structure and the use of various bank accounts and nominees can fundamentally weaken endeavours by FIUs, other capable specialists, and financial institutions to identify and confirm the beneficial owner.

### *Case Study 1, Complex structure (Money laundering)*

The accused laundered the proceeds of predicate offence of corruption and obtained pecuniary advantage through dishonest and illegal means.

Mr. X and Mr. Y (Prime Suspects) had cumulative shareholding of 50% in ABC, a Private Limited (Pvt. Ltd.) company. The remaining 50% shares were held by MIM and YK (suspects). The suspects “Modus Operandi” was the use of front companies for laundering the proceeds of crime using ABC Pvt. Ltd. and M/s DEF Private Limited, a Special Purpose Vehicle (SPV), which were dummy/shell companies.

M/s DEF Private Ltd. initially applied for a financing facility of Rs. 1.5 Billion (USD 9.68 Million) from a consortium of Banks i.e. NB and AH Banks of Pakistan. They mortgaged a commercial building (ABCD) owned by third party namely ABC (Pvt) Ltd. to the bank against the said loan. The valuation of the said property was fraudulently inflated (false value) by the accused in connivance with TR (Pvt) Ltd. (Surveyor of the Property).

The loan was approved and disbursed by the banks namely AH Bank, N Bank and XYZ. The funds were not used for the purpose mentioned at the time of seeking finance facility and were later misappropriated. To siphon off the disbursed funds of (RS1.5 billion), the suspects opened a bank account with false credentials in the name of ABC Pvt Ltd. in HL Bank.

Rs 1.5 Billion was then transferred to the bank account of dummy /shell company DEF (Pvt) Ltd, which was then fully transferred to ABC Pvt Ltd. in its new bank account with HL bank. Money was disbursed to suspects through fake bank accounts using bank pay orders. A JIT of supervisors and LEAs was constituted to investigate the fraud that lasted over 16 months., Assets including property valued at over Rs. 4 billion (USD 25.81 Million) was seized under a Court seizure order in terms of section 12 of National Accountability Ordinance (NAO), 1999.

## **1.2 Shelf and Shell Companies**

The 2014 FATF Guidance on Transparency and Beneficial Ownership defines shell companies as “companies that are incorporated, but which have no significant operations or related assets”. Shell

companies are the most widely recognized kind of legal person utilized in plans and structures intended to conceal beneficial ownership. Shell companies can be utilized in complex structures including the appropriation of resources across various organizations in numerous locales. At the point when these structures are utilized for unlawful purposes, cash may be transferred through different layers of shell companies before finally being removed in real money or moved to its last destination internationally.

Shell companies may register under the same procedures as any other company, and some attributes may demonstrate that a company is a shell, including the utilization of just a post-box address, an absence of employees, and non-payment of taxes. Besides, many shell companies don't have an actual presence, and are geographically secured using Trust and Company Service Providers (TCSPs) and nominee directors, whose administrative role is restricted.

Shelf companies are held inactive for a number of years and then sold. When sold, the directors resign and shareholders naturally transfer their shares to the new owner. As a component of the transfer agreement, the buyer may get the company's financial record, in the event that it is accessible. The only obvious change in the organization is a difference in proprietorship. The difference in ownership will only be clear if it is recorded in the company's database and by informing the competent authority. This is regularly "neglected" allowing shelf companies to become a tool to conceal beneficial ownership.

### ***Case Study 2, Shell Company (Money laundering)***

Mr. X made six shell companies in Jurisdiction Y and used the bank accounts of these companies to launder proceeds of crime of more than 1 billion GBP. The chargeable offence was illegal earnings. The six shell companies all had a single shared nominee shareholder.

### **1.3 Front Company**

Front companies are fully functioning companies with assets, income, expenses, and such other characteristics associated with the operations of businesses. The most widely recognized types of front organization are ones operating in hospitality or other cash intensive sectors, so that they may directly deal in money. Front organizations can be misused to make illegal money appear legitimate by claiming that the laundered money is owed to them through business dealings that are difficult to record and track. The company earns its share by taking cash from one BO (the client) and providing it to a second BO (the entrepreneur). At the point when a front organization is utilized for illegal activity the "client" is either the owner or an associate, and the exchange is recorded as a genuine client transaction, hence beneficial ownership is concealed.

### ***Case Study 4, Front Company (Money laundering)***

Drug syndicate based in a foreign country laundered proceeds from a cannabis deal by opening a company in which members of the syndicate were presented as employees. Individuals from the syndicate recorded their deal as income for the company. These were then transferred to the syndicate members as wages of an annual amount of 100,000 USD.

#### **1.4 Offshore Company**

An offshore company is an entity that conducts all of its transactions outside the borders where it is incorporated. Because it is owned and exists as a non-resident entity, it is not liable to local taxation as all of its financial transactions are made outside the boundaries of the jurisdiction. Offshore companies are established in foreign jurisdictions in order to make the most of local laws that offer low or tax exemption to non-resident companies.

##### ***Case Study 5, Offshore Company (Money laundering)***

A suspect was involved in concealing true ownership of funds through benami accounts and channeling of funds. A STR was filed by Bank A on the account of company ABC, which was registered in British Virgin Islands (BVI), and maintaining an account with Bank A in Pakistan. The suspicion was raised about the true beneficiary of funds as high amounts were routed from the account. The directors of the company were foreigners, while two Pakistanis were authorized to operate the account in Bank A. During analysis, high turnovers were noticed in the reported account comprising deposits through clearing of cheques, followed by immediate issuance of banker's cheques. Further, one of the authorized signatories of the account was identified as CFO of another Pakistani company (Company XYZ), and Mr. J the director/chairman of XYZ Company was found to be under investigation by one of the anti-graft LEAs regarding corrupt practices and scams in Pakistan. Moreover, both individuals (Suspect and Mr. J) were also found connected through common contact details. The case was referred to the LEA for further action.

#### **1.5 Company Assets held over multiple jurisdictions**

The freedom to open bank accounts across various countries globally is an inherently vulnerable freedom commonly exploited to obscure beneficial ownership. Banks cannot perform customer diligence as laboriously on foreign entities, as they can on local ones. Splitting of assets in such a manner limits the ability of investigative authorities to trace assets unless relevant cooperative treaties are in place with the relevant jurisdictions.

##### ***Case Study 6, Splitting of Assets over Multiple Jurisdictions (Money laundering)***

International Company X headquartered in jurisdiction (A) was using shell companies to pay bribes to government officials. Shell companies were registered in several jurisdictions and had nominee shareholders and directors. Company X made payments through the bank account of a subsidiary to an account in jurisdiction B routed through jurisdiction C, and then finally routed to an account in jurisdiction D. This process involved making payments to fake charities and paying off fake invoices to disguise the bribes.

#### **1.6 Bogus Loans and Invoices**

Businesses may fake invoices or a series thereof to a company beneficially owned by them or an associate through multiple legal persons and layers in order to show greater expenses. This is used for tax evasion. This is then returned to the original company in the form of a loan.

##### ***Case Study 7, Bogus invoices (Money laundering)***

Company Y issued false invoices to Company X for bogus brokering services. Company X paid for these services. Company Y after deducting a 10% fee returned the money to Company X as a fake loan, which they then wrote off.

## 1. 8 Manipulation of Information in a Company's Prospectus

A company may falsify information in their company prospectus and annual reports and get itself qualified for a listing on the stock exchange in the country of incorporation. While this measure is generally intended to improve the reputation and the economic activities of the company, it may also lead to a situation in which the company may be subject to reduced customer due diligence obligations. The ability for criminals to list a company on a stock exchange in a manipulative way can support future activities designed to obscure beneficial ownership, including the use of the company as a “front company”.

### *Case Study 8, Manipulation of Prospectus (Money laundering)*

Director Y of Company X overstated revenue by 300%. After being listed on the stock exchange Director Y opened a bank account and Company Z in jurisdiction A to trade illegally and hide his assets.

## 1.9 Virtual Currency

Virtual currency, or virtual money is a type of unregulated digital currency, which is issued and usually controlled by its developers and used and accepted among the members of a specific virtual community. Unlike regular money, virtual currency relies on a system of trust and may not be issued by a central bank or other banking regulatory authority. They derive their value based on the underlying mechanism such as mining in cases of cryptocurrencies, or backed by the underlying asset.

### *Case Study 9, Virtual Currencies (Money laundering)*

ABC Company and XYZ Company were suspected of being involved in trading and providing a platform for sale/purchase of virtual currency in Pakistan, which is prohibited activity in Pakistan. STRs were filed by WXY Bank on the account of company ABC and company XYZ on suspicion of operating as a VASP by trading VAs and providing platform to others for trading of VAs. Both companies were registered as software houses, but engaged in trading of VAs. One of the directors of company ABC was a close associate of a domestic politically exposed person (PEP). The directors of company XYZ husband and wife were residing in a foreign jurisdiction. During the analysis, high turnovers were noticed in the reported accounts using Inter Bank Fund Transfers (IBFTs) and internet transfers, deposits and withdrawals through ATMs and Cash deposit machines (CDMs). Moreover, transactions in the accounts were mostly of small amounts, but frequency of transactions remained exceptionally high. It was reported that the company had received funds from various individuals through internal funds transfers as investment in virtual currencies (Bitcoins).

Based on suspicion raised by the bank and the high volume of transactional activity in the accounts of company ABC & company XYZ, it appeared that the companies were facilitating/providing platform for trade of VAs in Pakistan. Further, keeping in view the potential involvement of third-party individuals who had invested in such companies for trade in VAs, the financial intelligence was shared with Federal Investigation Agency (FIA) and Securities and Exchange Commission of

Pakistan (SECP) under the AML Act 2010 for action deemed appropriate. Based on the FMU's intelligence the SECP issued warning letters to the concerned companies and initiated the audit of their financial books, while the FIA is investigating the matter in the context of ML.

### **1.10 Trusts, (Money laundering and Terrorist financing)**

While a majority of the Trusts are established for legitimate purposes criminal organizations may misuse trusts for their illicit activities involving money laundering and terrorist financing.

#### ***Case Study 11, Trust (Money laundering)***

XYZ Trust, an NPO owned by a well-known business group, opened a PKR account in the Trust's name in ABC Bank for charity collection purposes. However, there were numerous high value cash withdrawal transactions conducted in the account that were did not commensurate with XYZ Trust's disclosed profile. Bank observed that high value outward clearing cheques were credited in the account. The funds were then withdrawn through high value inward clearing cheques on the same or the very next day. This trend was followed for a long period. Accordingly, bank filed an STR.

Additional accounts maintained by XYZ Trust with other banks were identified during FMU analysis, wherein high volume of funds had been routed over a period of time. Large number of CTRs were identified against the signatories, mostly from the accounts maintained in the name of business entities. However, these business entities were observed to have paid very nominal amount in income taxes.

Signatories of XYZ Trust were involved with multiple businesses. They had been running the aforementioned trust for the purpose of charity, however, the high turnover and large number of high value currency transactions suggested that they were using the charity's tax-exempt status for evading income taxes.

#### ***Case Study 12, Trust (Money laundering)***

Mr. A established a revocable trust abroad with himself as settlor and a local TCSP acting as trustee. Mr. A also arranged for the incorporation of a Cayman Islands company known as 'Company B', with the local TCSP also acting as the registered office. The TCSP became aware of allegations relating to Mr. A and his involvement in an oil and gas contract scam which also involved members of a foreign government. Over a two-year period, the TCSP reported that the trust and underlying company had received numerous transfers of funds and property from what was now deemed to be questionable sources, which in turn heightened its suspicions and prompted an STR.

An analysis of the trust accounts revealed outgoing funds to individuals named in numerous media reports who allegedly took part in the kickback scandal. In response to a request, the foreign jurisdictions confirmed that Mr. A was being investigated for money laundering and corruption of government officials.

#### ***Case Study 13 Charitable Trust (Terrorist Financing)***

On 4 November 2010, X Trust, an NPO operating in Pakistan was found to be acting on behalf of and providing financial support to designated terrorist organizations, including al Qaida and affiliated organizations.

X Trust was found to be serving as a front to facilitate efforts and fundraising for YX ,an entity designated under UNSCR 1267. X Trust had provided support for militant activities in Afghanistan



and Pakistan, including financial and logistical support to foreign fighters operating in both countries. In early 2009, several prominent members of X Trust were recruiting students for terrorist activities in Afghanistan. X had also been involved in fundraising for YX, including for militant training and indoctrination at its mosques and madrassas. As of early 2009, X Trust had initiated a donation program in Pakistan to help support families of militants who had been arrested or killed. In addition, in early 2007, X Trust was raising funds on behalf of ZX, an alias for YZ. YZ had also provided financial support and other services to the Taliban, including financial support to wounded Taliban fighters from Afghanistan. This case demonstrates that terrorist group can use a charitable trust as a front organization to fund their criminal acts.

#### ***Case Study 14 Charitable Trust (Terrorist financing)***

X was arrested for collecting funds for a proscribed trust. The motorcycle under his use had the name of WS Trust (a proscribed organization) prominently displayed on the front and rear, while he was also carrying receipts for funds collected on behalf the WX trust. The case was referred to LEAs for Prosecution. This case demonstrates how a proscribed organization that has already been banned can be used by criminals to collect funds for their criminal acts.

#### **1.11 Manipulation of Legal Persons acting as Front NPOs for Terrorist financing**

Designated/proscribed entities may form LPs to act on their behalf to carry out their TF activities. Where LPs are customers of reporting entities, the REs must look into the funding sources of LPs to find out any linkages with designated/proscribed entities. For instance, a typology was observed in Pakistan wherein the designated/proscribed entities had formed front NPOs as a Cooperative Society (LP) to carry out TF activities on their behalf. These front NPOs (LPs) owned and controlled properties, which were being used for TF activities.

Proactive investigations undertaken by LEAs in Pakistan have led to the identification of 11 legal persons/entities (front NPOs) acting on behalf of UN designated persons and entities. The Government proscribed these entities under Anti-Terrorism Act, 1997 on 10 May, 2019. In addition, the registration of these legal persons with the relevant authorities was cancelled and parallel investigations into their properties undertaken by the LEAs. Investigations and prosecutions undertaken by Pakistan against the legal persons acting on behalf of the designated persons or entities have resulted in a number of convictions involving legal persons. These LP convictions include criminal, civil and administrative liabilities being imposed on the legal persons, including punishments of imprisonment awarded to the office bearers, fines, and forfeiture of properties.

#### ***Case study 15 (legal person/ front NPO for terrorist financing)***

While investigating the associates of UN Designated Entities (UNDE), the authorities identified management (office bearer) of Entity ABC a Cooperative Society (Legal person) having linkages with a UNDE. The entity ABC was registered in the province of Punjab for carrying out welfare activities as a front NPO of that Designated Entity. During the investigation process of LEAs, it was discovered that a number of properties were held by entity ABC. Investigations were undertaken into the properties owned or controlled by ABC, and details were obtained from concerned authorities which revealed that the properties remained in the control and possession of the office bearer (Mr. X) of entity ABC. Accordingly, entity ABC was proscribed under ATA, 1997 and its registration was cancelled/revoked.

In addition, entity ABC along with its office bearers were charged for offences under the terrorist financing provisions of ATA, 1997. After successful prosecution, sanctions imposed against entity ABC were as follows:

- Mr. x (the office bearer) of entity ABC, was convicted and sentenced to 5 years imprisonment, and also fined.
- The properties in the name of the legal person were forfeited in favour of the state.
- Entity ABC was also fined

### ***Case Study 16, Use of NPOs for Terrorist financing***

NPO receives donations from foreign donors for charitable purposes through banking channels. An authorized person of the NPO withdrew cash from the bank account and distributed the total cash withdrawn in the ratio of 30% for charitable projects and 70% for arming and funding of local terrorist groups.

## **6. Intermediaries for LPLAs**

### ***Vulnerability of Professionals***

In Pakistan activities related to formation and structuring of legal persons and arrangements is carried out by lawyers and accountants who act as Trust Company Service Providers (TCSPs). The role of these intermediaries is mostly present in concealment of beneficial ownership as formation of legal persons and arrangements and is largely their domain.

### ***Case Study 1 (Establishment of Legal Person)***

Person X devised a fraudulent loan scheme. With the help of his lawyer, he set up Company Y to generate loans from banks; they then created a number of legal entities ranging from corporations to trusts. By opening bank accounts in the names of these entities, X diverted loan proceeds meant for company Y into these bank accounts for personal use.

### ***Case Study 2 - (Nominee Directors/Shareholders and Complex Structures)***

A law firm in jurisdiction X with international clients set up numerous LLPs and companies using their employees as nominee directors and shareholders. This was done to conceal beneficial ownership of clients and their associates. They further established a chain of ownerships using companies as shareholders, and a shell company as a trustee. Some of these legal persons were set up internationally to further obscure the identity of the beneficial owners. These structures and arrangements were quite effective in hiding wealth for these clients.

### ***Case Study 3 - Trust (Money laundering)***

The LEAs in Italy seized funds traceable to a single family that were held in the Channel Islands for a total value of EUR 1.3 billion. The assets were concealed through a complex network of trusts. Multiple trust accounts were hiding the beneficiaries of assets consisting in public debt securities and cash. The investigation established that between 1996 and 2006, the subjects placed their assets in Dutch and Luxembourgian companies through complex corporate operations and then transferring them to different trusts in the Channel Islands.

Subsequently, the funds were legally repatriated through a tax amnesty in December 2009. The investigation identified chartered accountants who had over time facilitated the concealing of funds through trusts with the aim of facilitating laundering and reinvestment.



## **7. Red flag indicating misuse of LPLAs**

Based on the above, all relevant stakeholders should consider following red flags indicating misuse of LPLAs:

- Using LP or LAs as a front entity with little underlying operations for laundering illicit finance
- Use of complex ownership and control structures to obscure beneficial ownership
- Mismatched business profile with unusual transaction behavior or activity
- Large cash deposits and withdrawals with dubious underlying operations
- Using non-profit operations as a front end to seek donations for terrorist activities
- Structuring of transactions with mismatch between transactions and nature of business
- Entity unable to provide a satisfactory explanation regarding the pass-through nature of the transactions and reasons for fund transfers between companies with seemingly unrelated business profile.
- High turn-over of funds within a relatively short period of time without any plausible explanations.
- Unclear relationships between ‘connected or associated’ companies and/or persons
- Frequent/multiple transaction involving entities with the same beneficial owner which did not make economic sense
- Deliberate avoidance of formal banking service without legitimate reasons
- Use of influential names (indicating linkage with NPOs, highly trending terminologies or government linked entities) where the actual operations cannot be directly validated.
- Co-mingling of business and personal funds
- Unable to establish relationship between the beneficial owner and authorized signatory of the company.
- Lack of or frequent failure to comply with disclosure requirements for public interest entity
- There is adverse information relating to the entity and/or its management.
- The investments are not in line with the net worth of the client.
- The underlying investments of the PIF and their value, where known, are unusual in nature or not substantiated.
- Inconsistencies in the information relating to purpose of the entity and source of funding
- LP or LAs using financial services based on the name of entity whose license or registration has already been revoked or cancelled by the concerned authorities
- LP or LA having no physical operational presence or employees

## **8. Recommendations and Best practices**

Supervisors, financial institutions, law enforcement agencies and relevant stakeholders should consider following recommendations or best practices to improve the detection of the misuse of Legal Persons:

- ▶ Perform due diligence to understand if the purported nature of business is aligned to the customer’s business including understanding the corporate structure and ownership, where red flags are noted
- ▶ Using a risk based approach, obtain information about customer at on-boarding and during ongoing monitoring of customer while considering publicly available information from relevant authorities
- ▶ Obtain corroborative evidence for the underlying transactions, where transactions are not in line with commonly observed transactions, industry practice to confirm the veracity of customer’s declaration.
- ▶ Implement systems that allow financial institutions to review transaction behaviour of related entities (including individuals & entities) in a holistic manner to Evaluating the reasonableness of transactions.
- ▶ Obtain reasonable justification for the use of cash deposits rather than using formal banking system.
- ▶ Understand the rationale for the appointment of authorised signatories, where they appear to be unrelated to the company’s business operations or ownership.
- ▶ consider the use of data analytics to detect hidden relationships.

## Annexure-A: Regulatory Obligations for Legal Persons and Arrangements regarding Beneficial Ownership requirements

In line with FATF Recommendations 24 and 25, legislation and regulations are in place to require legal persons and arrangements to obtain adequate, accurate and timely beneficial ownership information. A beneficial owner has been defined as a natural person who ultimately owns or controls a society, whether directly or indirectly or voting rights or by exercising effective control in that society through such other means as may be prescribed.

Relevant legislative amendments and subsidiary regulations that obligate legal persons and arrangements are provided below.

### Legal and Regulatory Obligations of Legal Persons

On 27 August 2020, Companies Amendment Act 2020 and Limited Liability Partnership Amendment Act, 2020 were enacted to introduce requirements for all companies and LLPs to obtain and maintain ultimate beneficial ownership information. Relevant sections of the Acts and subsidiary regulations are provided below.

S. No	Description	Relevant Sections	Relevant rules/ regulations
1	Requires information to be provided to authorities regarding the beneficial ownership (BO) of Companies	• Section 123A (1) of Companies Act 2017	○ Regulation 9 of the Companies (Incorporation) Regulations, 2017, ○ Regulation 19A of the Companies (General Provisions & Forms) Regulations, 2018,
2	Requires updated information in case of any change in the particulars of a BO	• Section 123A (2) of Companies Act 2017*	○ Regulation 6A of the Foreign Companies Regulations, 2018:
3	Requires information to be provided to authorities regarding the beneficial ownership of LLPs	• Section 8 of LLP Act, 2017**	○ Regulation 14A of the Limited Liability Partnership Regulations, 2018.)

Link for Companies Act, 2017 (Link: <https://www.secp.gov.pk/document/companies-amendment-act-2020-gazette-copy/?wpdmdl=40368&refresh=601f969dc36411612682909>)

\*\*Link for LLP Act, 2017 (Link: <https://www.secp.gov.pk/document/limited-liability-amendments-act-2020-gazette-copy/?wpdmdl=40369&refresh=601f969dc5ee11612682909>).

**Cooperative Societies**

Relevant legislative amendments and subsidiary regulations applicable to Cooperative Societies are provided below for your information.

<b>S. No</b>	<b>Description</b>	<b>Relevant Sections</b>	<b>Relevant rules/ regulations</b>
1	Requires information to be provided to authorities regarding beneficial ownership. The Secretary of the Society shall provide the information to a competent authority.  Requirement to keep a register of Cooperative Societies containing all basic and beneficial information	<ul style="list-style-type: none"> <li>• Section 20A(ii) of Baluchistan Cooperatives Societies Act, 2020</li> <li>• Section 26(2) of Sindh Cooperatives Societies Act, 2020,</li> <li>• 20-C (2) of KPK Cooperatives Societies Act, 2020,</li> <li>• 20A (2) of Punjab Cooperatives Societies Act, 2020</li> <li>• 20A (2) of ICT Cooperatives Societies Act, 2020</li> </ul>	<ul style="list-style-type: none"> <li>• Rule 14 of KPK Cooperative Rules 2020.</li> <li>• Rule 14 of Punjab Cooperative Rules 2020</li> <li>• Rule 18 of Sindh Cooperative Rules 2020</li> <li>• Rule 14 of Baluchistan Cooperative Rules 2020</li> <li>• Rule 52(9) of KPK cooperative societies rules</li> <li>• Rule 52(9) of Baluchistan /cooperative societies rules,</li> </ul>
2	Every Society shall provide the information about its beneficial owners within three months to the Registrar	<ul style="list-style-type: none"> <li>• Section 21-A (2) of Baluchistan, Cooperatives Societies Act, 2020</li> <li>• Section 29(2) of Sindh Cooperatives Societies Act, 2020,</li> <li>• Section 21-A (2)) of KPK Cooperatives Societies Act, 2020,</li> <li>• Section 21-A (2) of Punjab Cooperatives Societies Act, 2020.</li> <li>• Section 21-A (2) of ICT Cooperatives Societies Act, 2020.</li> </ul>	<ul style="list-style-type: none"> <li>• Rule 56(6) of Sindh cooperative societies rules</li> <li>• Rule 14(aa) of Punjab cooperative societies rules</li> </ul>

## Regulatory Obligations for Legal Arrangements

In light of FATF Recommendations, in 2020, legal amendments were made in the laws of each province and ICT to ensure that trusts and waqfs obtain and maintain relevant BO information. The relevant legislative amendments and subsidiary regulations are provided below:

### Trusts

S.no	Description	Acts	Relevant rules
1	The trustee is required to provide detailed information regarding ultimate effective control including Author of the trust, purpose, details of trustee and beneficiaries etc. at the time of registration. The registration is carried out after verification of provided information. Require a trustee to disclose his status as such prior to entering into a business relationship or conducting an occasional transaction with a reporting entity	<ul style="list-style-type: none"> <li>• Section 16 of Punjab Trust Act 2020.</li> <li>• Section 13 of KPK, Sindh and Baluchistan and ICT Trust Act 2020.</li> </ul>	<ul style="list-style-type: none"> <li>• Section 7 Punjab Trusts Rules 2020</li> <li>• Section 7 Sindh Trusts Rules 2020</li> <li>• Section 7 KPK Trusts Rules 2020</li> <li>• Section 7 Baluchistan Trusts Rules 2020</li> </ul>
2	Requires trustees to collect and hold basic information about the author, trustees, beneficiaries and any other natural persons exercising ultimate effective control over the trust.	<ul style="list-style-type: none"> <li>• Section 24(1) of Punjab, Sindh and Baluchistan Trust Act 2020.</li> <li>• Section 26(1) of KPK trusts Act 2020.</li> <li>• Section 23(1) of ICT Trust Act 2020.</li> </ul>	
4	Required to maintain the information referred to in this criterion (as above) for at least five years after their involvement with the trust ceases.	<ul style="list-style-type: none"> <li>• Section 32(f) of Punjab Trust Act 2020.</li> <li>• Section 32(f) of Baluchistan Trust Act 2020</li> <li>• Section 32(f) of Sindh Trust Acts</li> <li>• Section 34 (f) of KPK Trust Act 2020</li> <li>• section 31(f) of ICT Trust Act 2020</li> </ul>	

### Waqfs

S. No	Description	Acts	Relevant rules
1	Require a manager of a Waqf to obtain and hold prescribed information that is required to be provided as part of a registration of a Waqf (prescribed information is set out in rules and includes information about beneficial ownership) Provide information about the waqf and its BO to be shared with competent authorities and reporting entities upon request.	<ul style="list-style-type: none"> <li>• Section 6(4) of Punjab Waqf Act 2020.</li> <li>• Section 6(A) of KPK, Waqf Act 2020.</li> <li>• Section 7 of Sindh, Waqf Act 2020.</li> <li>• Section 8 of Baluchistan, Waqf Act 2020.</li> <li>• Section 7 of ICT Waqf Act 2020</li> </ul>	<ul style="list-style-type: none"> <li>• Section 3 Punjab Waqf Rules 2020.</li> <li>• Section 5 Baluchistan Waqf Rules 2020.</li> <li>• Section 4 Sindh Waqf Rules 2020.</li> <li>• Section 5 Baluchistan Waqf Rules 2020.</li> </ul>