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Shell Companies, Corrupt Practices, and How to Uncover Them

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Objectives

- What are shell companies and how are they relevant for fraudulent acts?
- Ways people abuse shell companies for fraud
- Legitimate reasons to set up shell companies
- Tools to detect whether a shell company is being used for illegitimate purposes



\$23B

The global illegal wildlife trade generates between \$7 billion and \$23 billion in illicit revenue annually.* The trade can involve a range of criminal activities, from trafficking and forgery to bribes and use of shell companies.¹

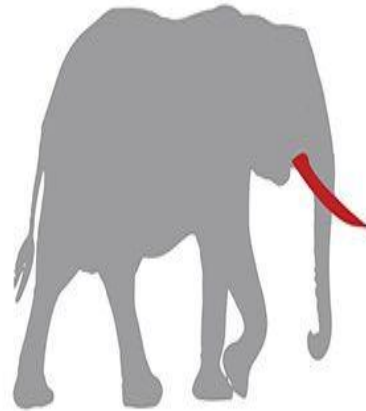
9,246%

In 2007, South Africa lost 13 rhinos. In 2014, it lost 1,215—an increase of more than 9,000%.²



\$60,000

Increasing demand for rhino horn in Asia has fueled black market prices. Rhino horn is said to go for \$60,000 per kg (\$132,000/lb).³



100,000

As many as 100,000 African elephants—33,000 per year—were killed between the years 2010 and 2012. More than 65% of Central Africa's forest elephant population has been wiped out in the last decade.⁵



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Shell companies steal millions in Medicare fraud

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Shell companies—sham firms on paper with no real operations—are a prime tool for fraudsters to scam Medicare out of millions of dollars, according to a Reuters investigation. Medicare's current pay-and-chase system has holes that allow providers (or imposter providers) to bill Medicare for services and then steal millions of dollars from the federal health program.

For instance, Florida authorities charged Michel De Jesus Huarte for his role in setting up fake AIDS clinics in Florida, but not before he billed Medicare for more than \$4.5 million and formed at least 29 other shell companies in Florida, Georgia, Louisiana, North Carolina and South Carolina, Reuters reports. Huarte and co-conspirators formed clinics purported to treat HIV and AIDS patients and submitted claims for expensive drugs such as Infliximab and Rituxan, costing Medicare as much as \$7,800 per dose.

"This is a 'Catch Me If You Can' environment," said Ryan K. Stumphauer, a former assistant U.S. attorney with the Department of Justice in Miami who prosecuted Huarte. "We had no clue who Huarte was. We had no idea there was some mastermind out there."

The strategy of shell companies can go unnoticed for years. Scam artists use fake names and addresses for corporations or real information from others. In Florida, Federal Bureau of Investigation agents said almost every Medicare fraud case involved a shell company.

Florida, where the fake AIDS clinic scheme took place, is one of five states that tops the list for the most Medicaid fraud activity, according to a recent Office of Inspector General report issued in October; the other states are New York, Texas, California and Ohio.

The Centers for Medicare & Medicaid Services (CMS) last month announced that hospitals soon will be subject to prepayment audits, with aims to fix the traditional pay-and-chase method. Effective January 2012, Medicare recovery audit contractors (RAC) in 11 states will conduct reviews of

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5 Cases of US Shell Companies Aiding Criminal Conduct

For all the talk about money laundering risks associated with [offshore shell companies](#), the U.S. has continued allowing for anonymous firms. These banks incorporate and come with loose requirements, such as Delaware, which one report called an "Offshore Offshore." The U.S. Senate has failed at [passing legislation](#) creating a national standard for identifying beneficial owners of companies at incorporation, though the [scorecard](#) [aligns for success](#). The White House said [this week](#) that it's trying to take action on the issue. A recent [Global Witness report](#), which compiled 22 cases of shell companies facilitating crime based in 27 U.S. states, said investors, the U.S. government and others can be harmed by anonymous firms. The group advocates for a public registry of beneficial owners, saying it would help business know their customers and law enforcement to conduct investigations. Here are some more cases [Global Witness](#) didn't cite.

3 OCT 2014 10:19AM BY SAMUEL RUBENFELD [COMMENT](#)

1 US Seizes Ex-South Korean President's Assets Tied to US Shell

When U.S. prosecutors in February seized assets from Chun Doo-hwan, former president of South Korea, [they said](#) he used shell companies in the U.S. and Korea to launder more than \$200 million in bribes. He was previously convicted in South Korea of taking bribes while in office. Representatives for him could not be located.

2 US Shell Company Aids Lufthansa Unit's Bribery Scheme

A California-based company aided a bribery scheme by Boeing, a unit of U.S. defense group AEC, prosecutors said.

What Is a Shell Company & Is it Legal?



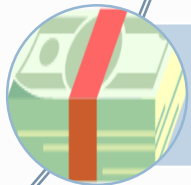
Shells can be legitimate, legal entities that do not possess actual assets or run business operations. They are non-traded corporations (i.e., they are not listed on the stock exchange for buying and selling to investors).



Most exist in name only as a registered financial entity or as a mailing address.



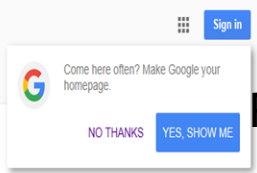
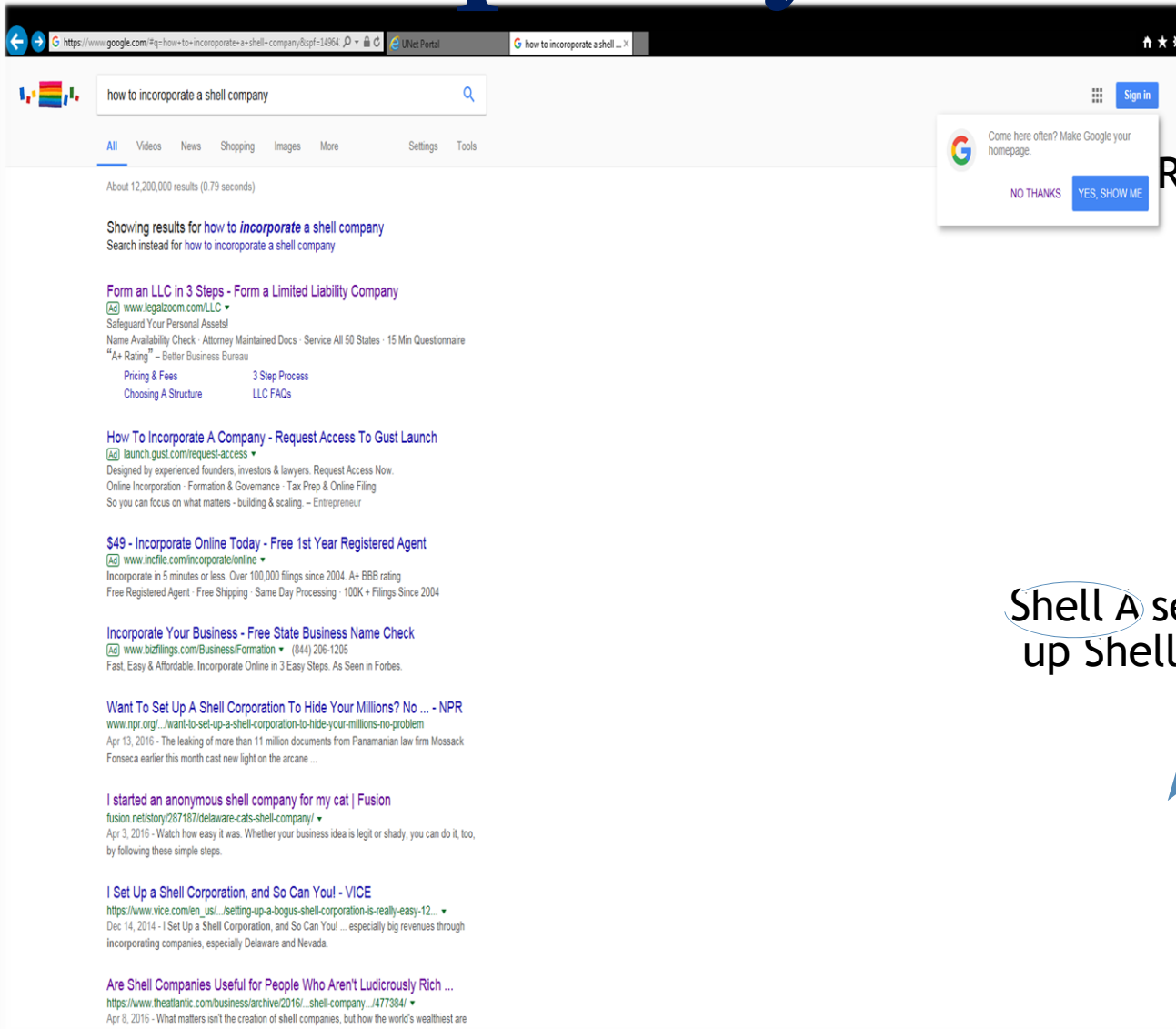
It is used as a “pass through” to allow other companies or businesses to smoothly move financial assets from one country to another.



It is sometimes difficult to identify the real owners.



Simplicity of Forming a Shell



Registered Agent

Location/ State favored for Shell formation: Shell A



Identification

Shell A sets up Shell B

"Beneficial Owner"

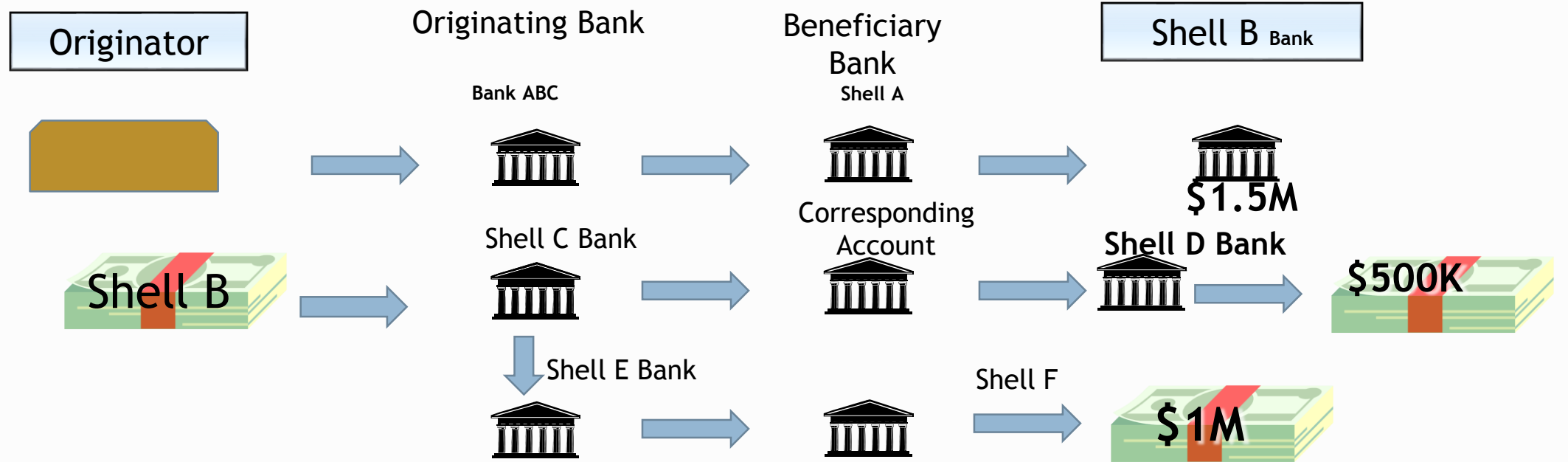


Movement via the Electronic Transfer System

- Society of Worldwide Interbank Financial Telecommunications System (SWIFT)
- Federal Reserve (FedWire)
- Clearing House Interbank Payments System (CHIPS)
- Emerging Areas: Virtual Currencies, Online systems (PayPal).



Complexity of Fund Transfers



Ways People Abuse Shell Companies for Fraud



What is money laundering?

Processing assets (money or property) in ways which mask ownership of those assets and makes them appear to have come from legitimate sources.

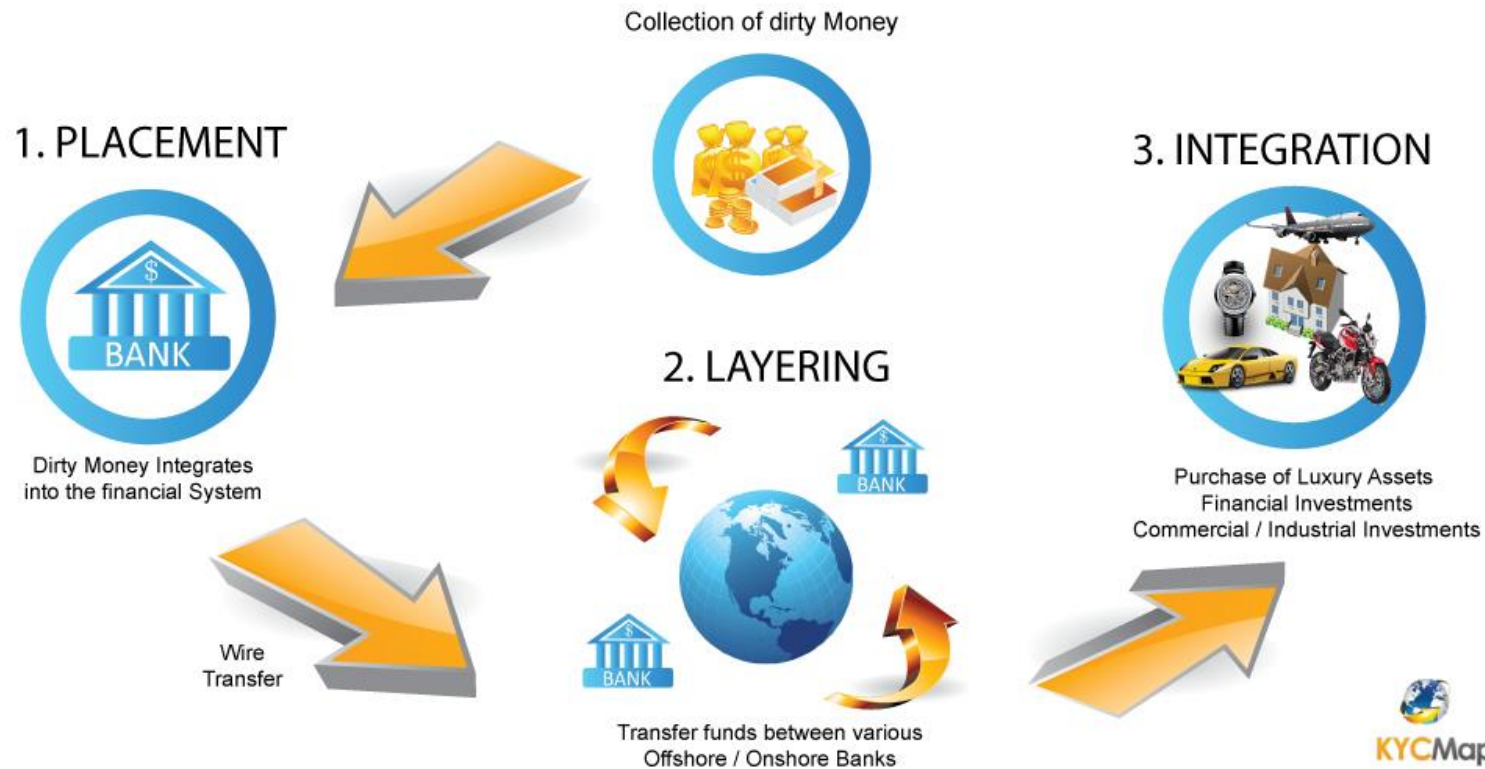
➤ Turning “dirty” money into “clean funds”

Helps criminals hide and accumulate wealth, avoid prosecution, evade taxes, increase profits through reinvestment and fund further criminal activity.



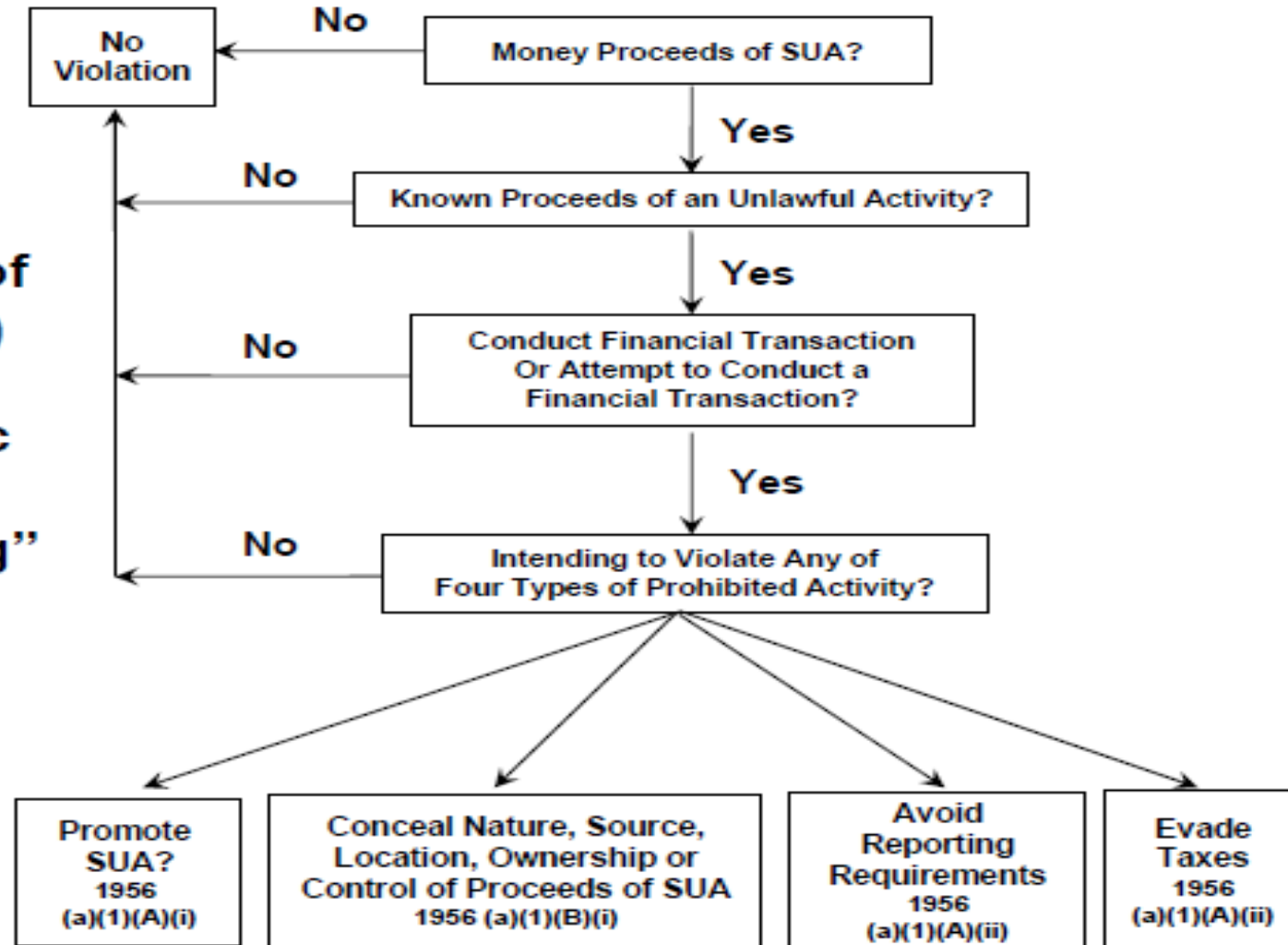
The Money Laundering Process

A TYPICAL MONEY LAUNDERING SCHEME



Elements of Money Laundering

Analysis of
1956 (a)(1)
"Domestic
Money
Laundering"



Criminal Penalties for 1956 and 1957

1956:

- Fine of not more than \$500,000 or 2X the value of the property (whichever is greater) and/or
- Imprisonment for not more than 20 years

1957:

- Fine under Section 18 and/or
- Imprisonment for not more than 10 years





Other Areas Shells Are Used for Corrupt Practices

- To conceal the movement of contraband in commerce
- Circumvent regulations and tax fraud
- Sanctions and sanctions busting
 - Sanctions are imposed on many countries, businesses, and individuals to limit importation of military equipment or ammunition or ban the export of oil, metal, and other commodities.



Other Areas Shells Are Used for Corrupt Practices

- Insider Disbursement Fraud
 - The shell Company alleges to provide services.
 - They claim to offer highly technical services and the company is reliant on the expertise of a single individual to oversee the vendor.
- Channel for paying bribes
- Hacktivism – gaining access to data



Legitimate Reasons to Set Up Shell Companies

- To save up funds to open a business
- As a front for product development that a well-established company may want to keep private until it is ready.
- Facilitate financial institutions to perform financial activity in foreign markets
- They are used to obtain financing, maintaining control over Conglomerate Company
- Realize a “tax haven” abroad



Investigative Red Flags



- Payments that have no stated purpose, do not reference goods or services, or identify only a contract or invoice number.
- Purpose of the company is unknown or unclear.
- Goods or services identified do not match company profile.
- Or responding bank provides dissimilar goods and services in relation to the company transferring the funds, or explanation given by respondent bank is inconsistent with observed funds transfer activity.
- Fund transfers are sent in large, round-dollar amounts.



Investigative Red Flags

- Insufficient information available to positively identify originators or beneficiaries of funds transfers.

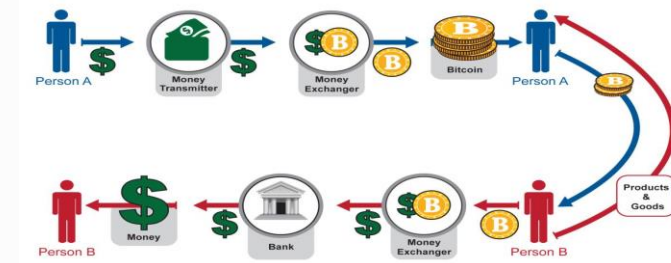
- Company has little or no internet presence.

- Unusually large number of beneficiaries receiving transfers from one company.

- Payments flow from one Shell Company to another with no apparent legitimate business purpose.

- Funds usually pass through jurisdictions or beneficiaries located in high risk jurisdictions.

- Transacting businesses share the same address, provide only a registered agent's address, or other inconsistencies.



Additional Tools to detect Corrupt Shells

- Conduct due diligence research utilizing various software to obtain affiliation for shells with suspicious fund transfers.
- Utilize resources available to assist with ownership identity and information on shell companies. This includes:
 - Conducting global research in various databases and company registries
 - Dun & Bradstreet and LexisNexus searches
 - Anti-money laundering software
- Be familiar with the foreign framework in which the U.S.-based Shell company can be used to hide ownership and facilitate the movement of billions of dollars in international wire transfers.



Additional Tools to Detect Corrupt Shells

- Web History
 - An initial search may show individuals in control of the company.
 - Many companies list names and phone numbers for their executives and boards of directors on their website to appear accountable and legitimate.
 - Others lack board of directors information.
 - Many companies don't have a websites and create a short paper trail.



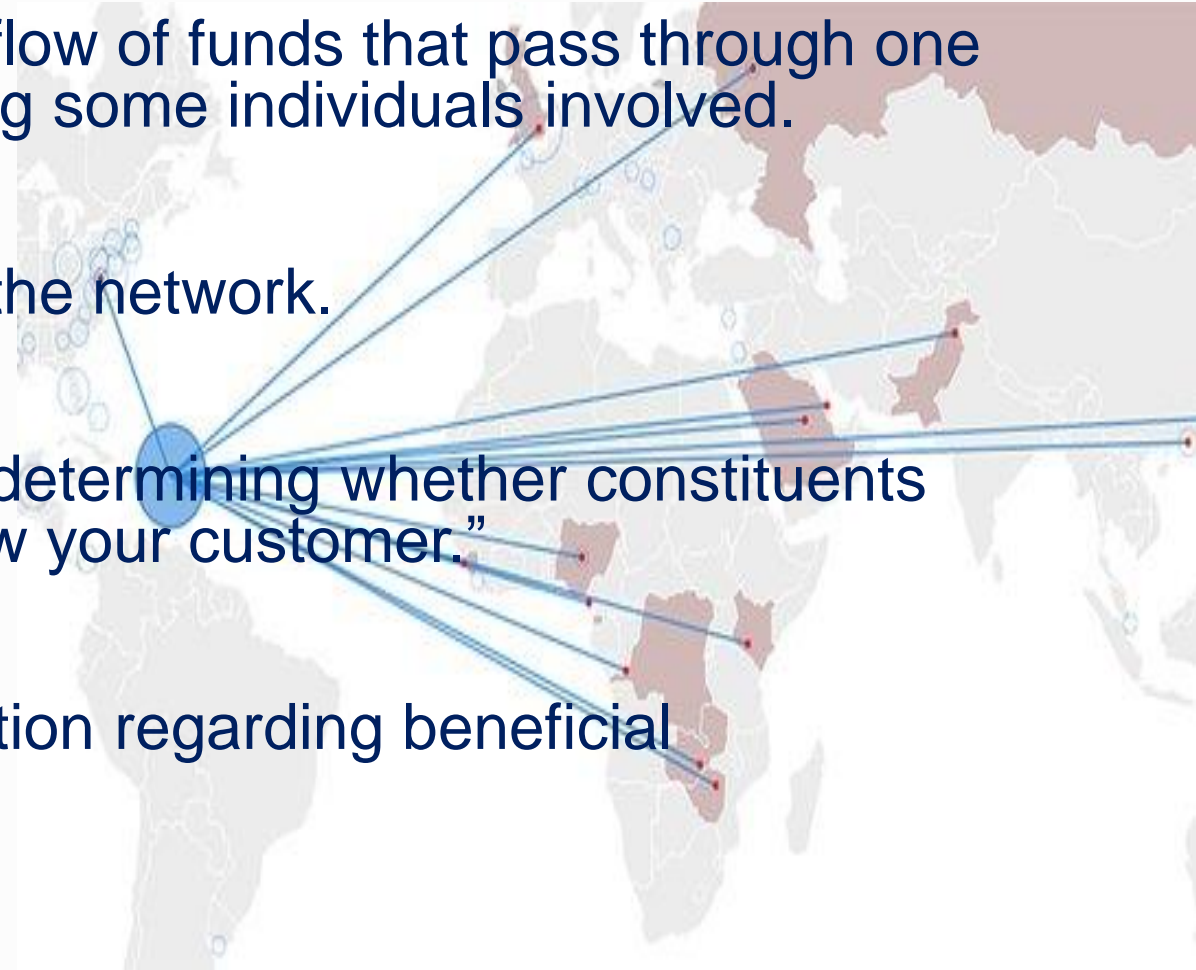
Whois Website

The screenshot shows the Whois.com website interface. At the top, the navigation menu includes: DOMAINS, HOSTING, CLOUD (with a 'NEW' badge), WEBSITES, EMAIL, SECURITY, WHOIS, SUPPORT, LOGIN, and a shopping cart icon with '0' items. The main heading is 'WHOIS Lookup' with the subtext 'Search domain name registration records'. Below this is a search input field with the placeholder text 'Enter Domain Name or IP Address' and a green 'SEARCH' button. Examples of domain names are listed: qq.com, google.co.in, bbc.co.uk, and ebay.ca. On the right side, there are two promotional banners. The top one is for '.live' domains, showing a 'Sale' with a price of '\$23.88' crossed out and '\$2.88' in green, with a 'BUY NOW' button and a note '*Offer ends 30th April 2017 UTC'. The bottom banner is for '.club' domains, titled 'Hot Deals!', showing the '.club @ \$1.48' price with '\$41.88' crossed out.



Additional Tools to detect Corrupt Shells

- “Follow the Money” - Reviewing the flow of funds that pass through one entity to another is useful in identifying some individuals involved.
- Mapping tools assist with identifying the network.
- Work with regulators and auditors in determining whether constituents are complying with regulations. “Know your customer.”
- Become familiar with evolving legislation regarding beneficial ownership.



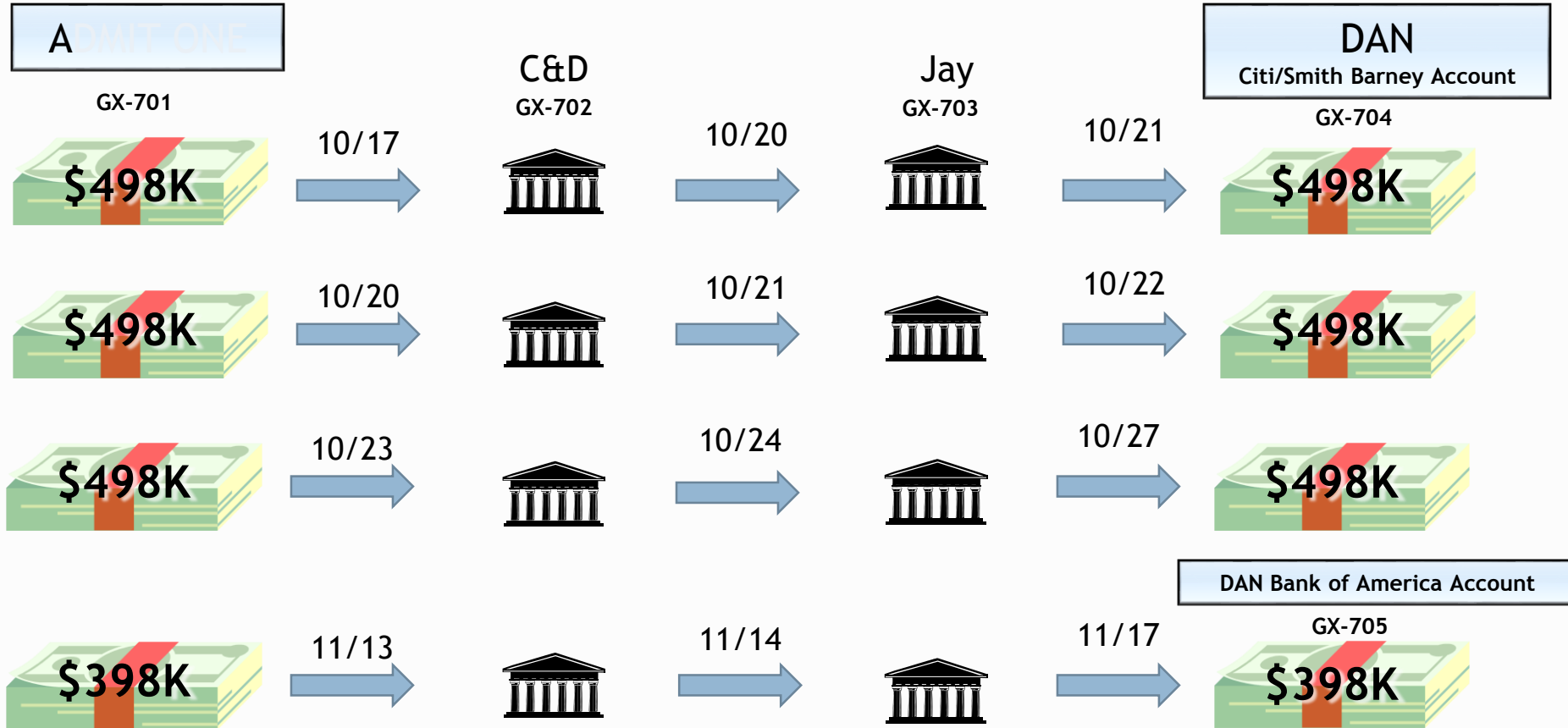
Case Study: “A” Payments to C & D Sales (Shell)

Payment Date	Amount	Contract*
10/17/2008	\$498K	PSLs
10/20/2008	\$498K	PSLs
10/23/2008	\$498K	PSLs
11/13/2008	\$398K	PSLs
12/23/2008	\$560K	U.S. Open Golf
12/23/2008	\$398K	PSLs
12/29/2008	\$532K	PSLs
1/2/2009	\$498K	PSLs
1/6/2009	\$200k	PSLs
Total	\$4.08 million	

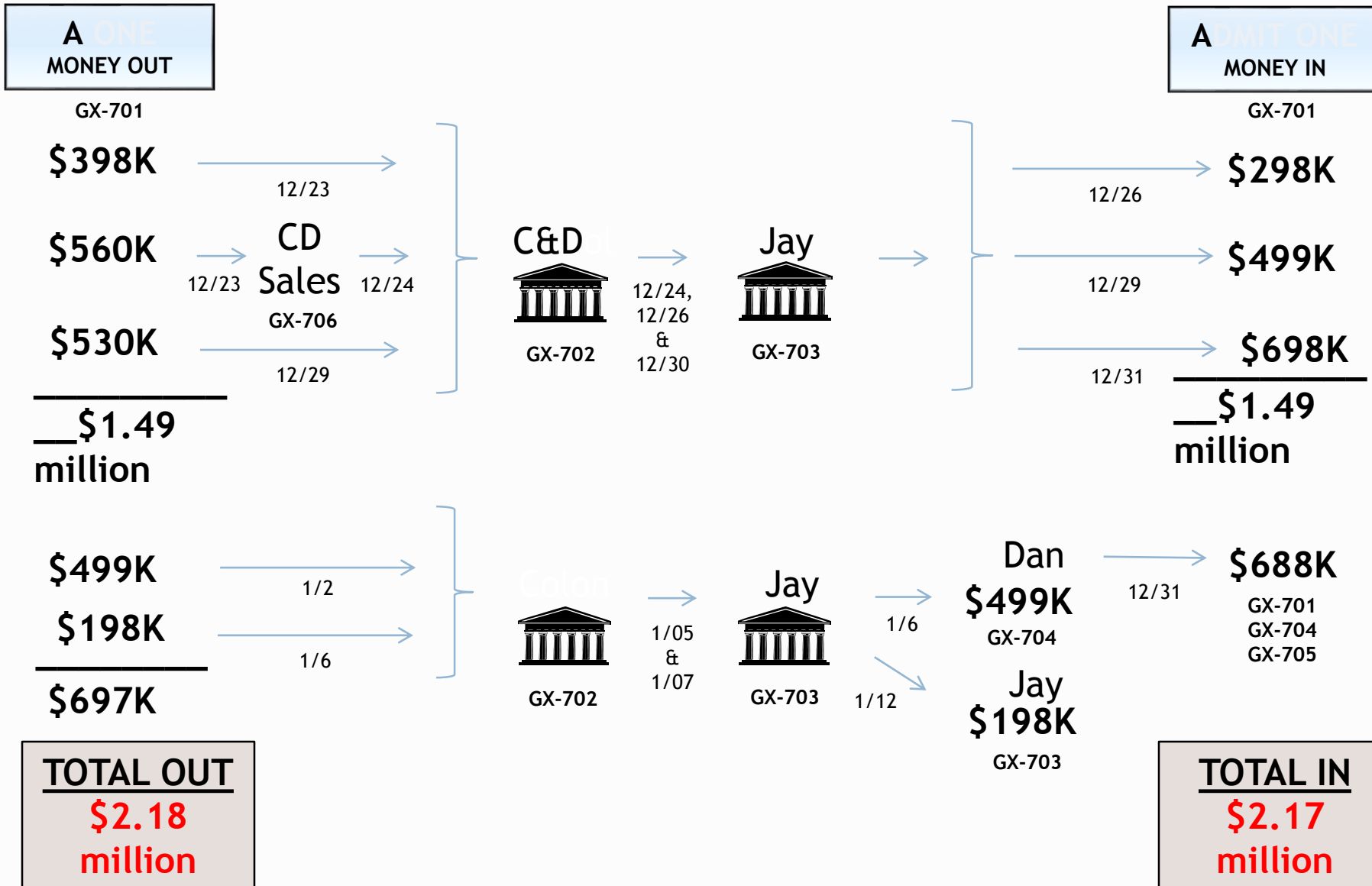
* PSL Payments: GX-502, GX-505, GX-510 (note E), less \$82.5k claimed for another contract
 US Open Golf Payment: per GX-504



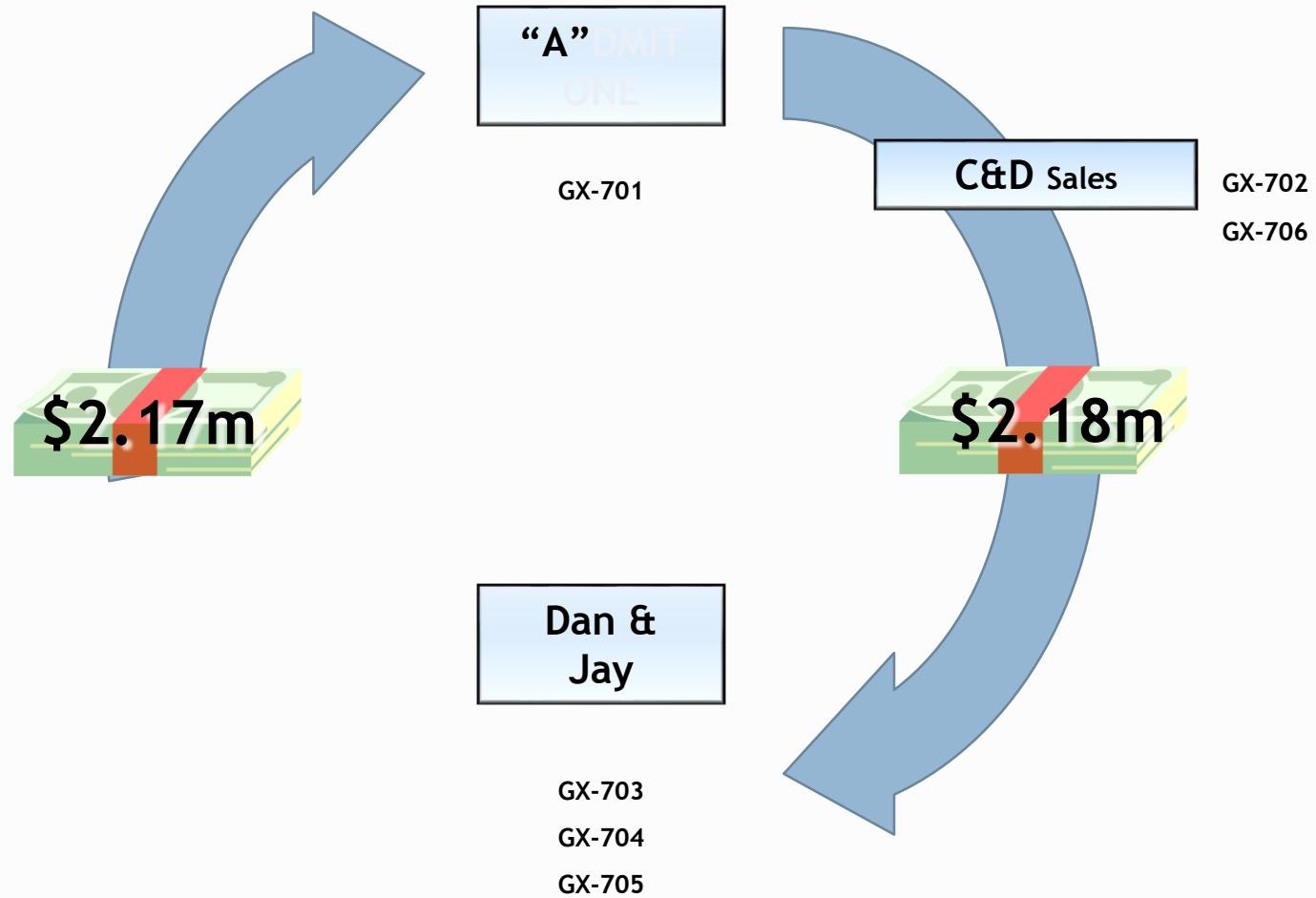
Oct/Nov 2008 Transfers



End-of-Year 2008 Transfers



End-of-Year 2008 Transfers



A Payments to C & D Sales

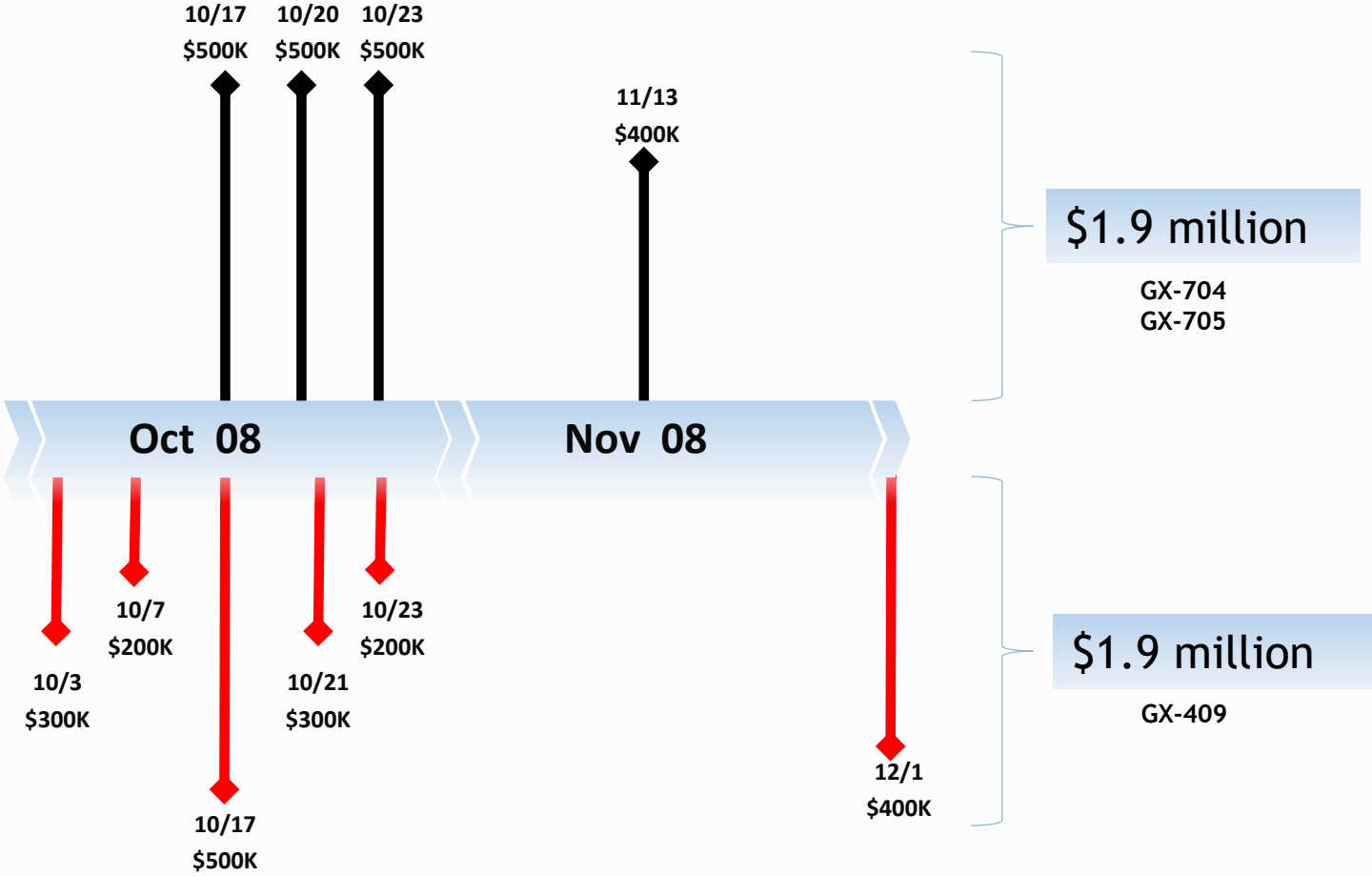
Payment Date	Amount	Contract*	Where Money Goes**
10/17/2008	\$498K	PSLs	\$498K to Dan
10/20/2008	\$498K	PSLs	\$498K to Dan
10/23/2008	\$498K	PSLs	\$498K to Dan
11/13/2008	\$398K	PSLs	\$300K Dan / \$98K Jay
12/23/2008	\$560K	US Open Golf	A Company
12/23/2008	\$398K	PSLs	A Company
12/29/2008	\$532K	PSLs	A Company
1/2/2009	\$498K	PSLs	A Company
1/6/2009	\$200k	PSLs	A Company
Total:	\$4.08 million	Total to Dan:	\$1.89 million

* PSL Payments: GX-502, GX-505, GX-510 (note E), less \$82.5k claimed for another contract
 US Open Golf Payment: GX-504

** GX-701 through GX-706



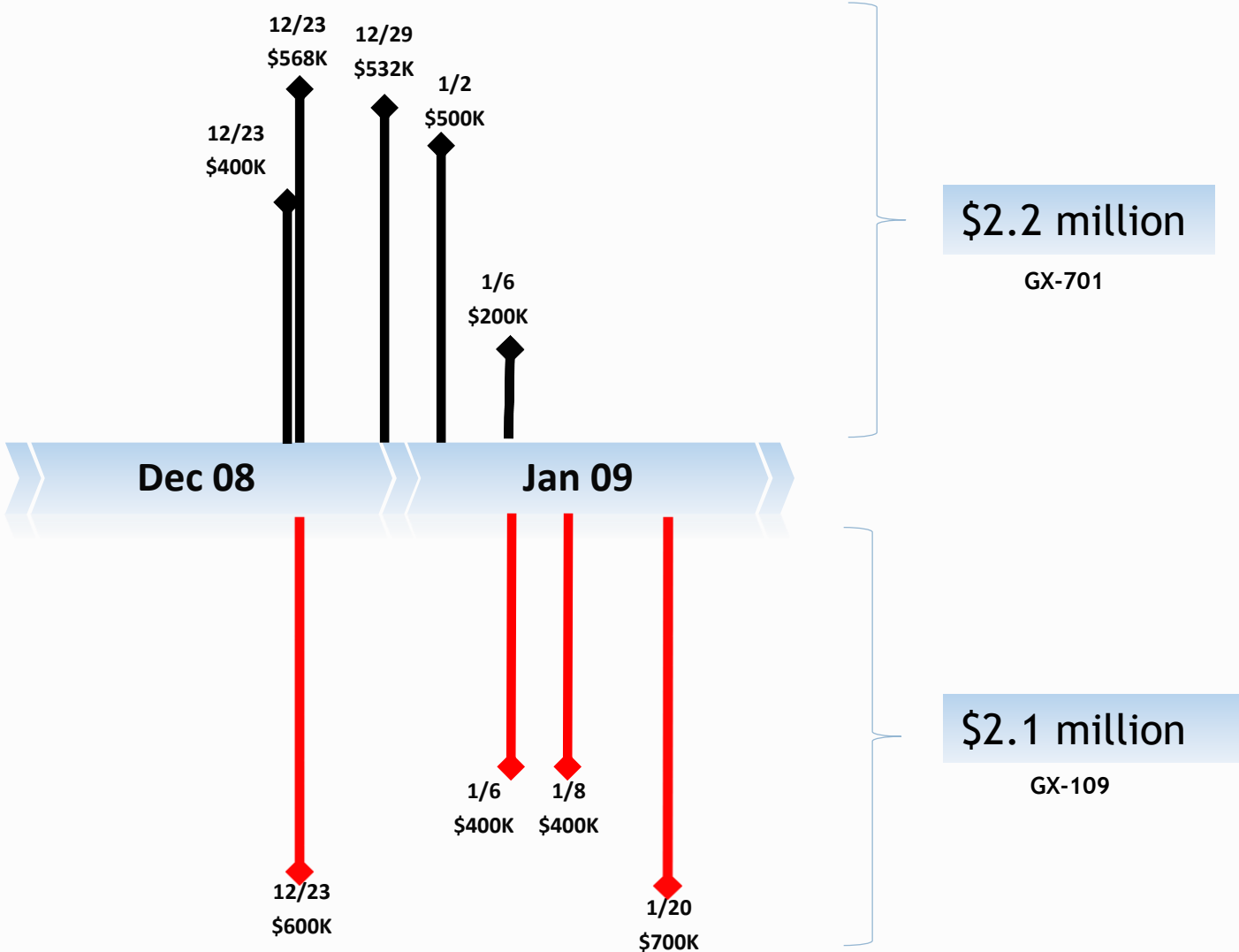
Oct/Nov Payments Claimed for PSLs



Drawdowns from BOACredit Line



End-of-Year Payments Claimed for PSLs/US Open Golf



Drawdowns from BOACredit Line



Credit Line Balances for Oct '08 – Jan '09

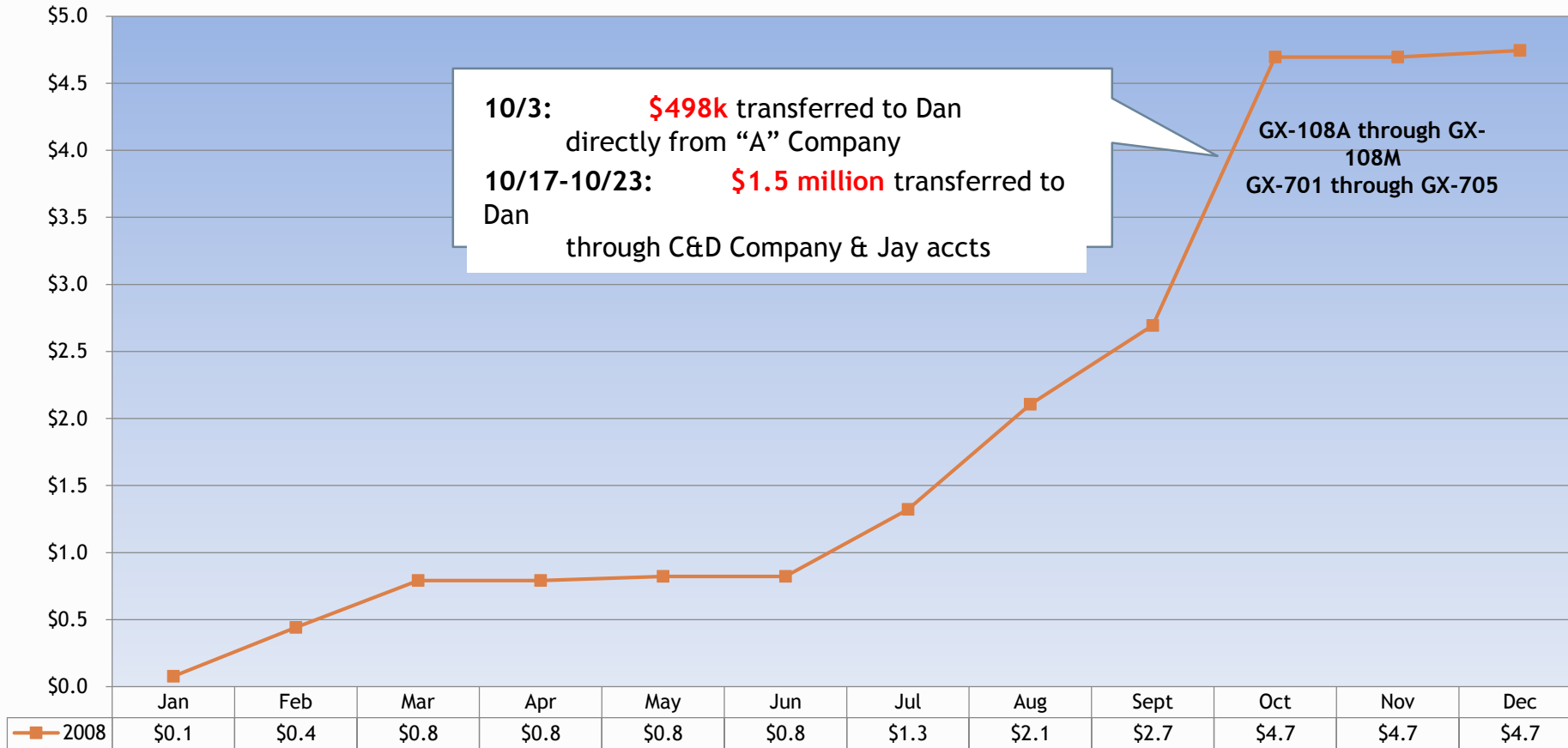
GX-109

Balance as of October 1, 2008:	\$ 5 million
Total Drawn Down by A Company:	+ \$ 4 million
<hr/>	
Total Paid Back by A Company:	– \$ 2.5 million
Balance as of January 20, 2009:	\$6.5 million

NET CHANGE
\$1.5 million
increase in debt



Z Brokerage Account (Citi/Smith Barney) 2008 Year-to-Date Monthly Deposits (\$'s IN MILLIONS)



10/3: **\$498k** transferred to Dan directly from "A" Company
 10/17-10/23: **\$1.5 million** transferred to Dan through C&D Company & Jay accts

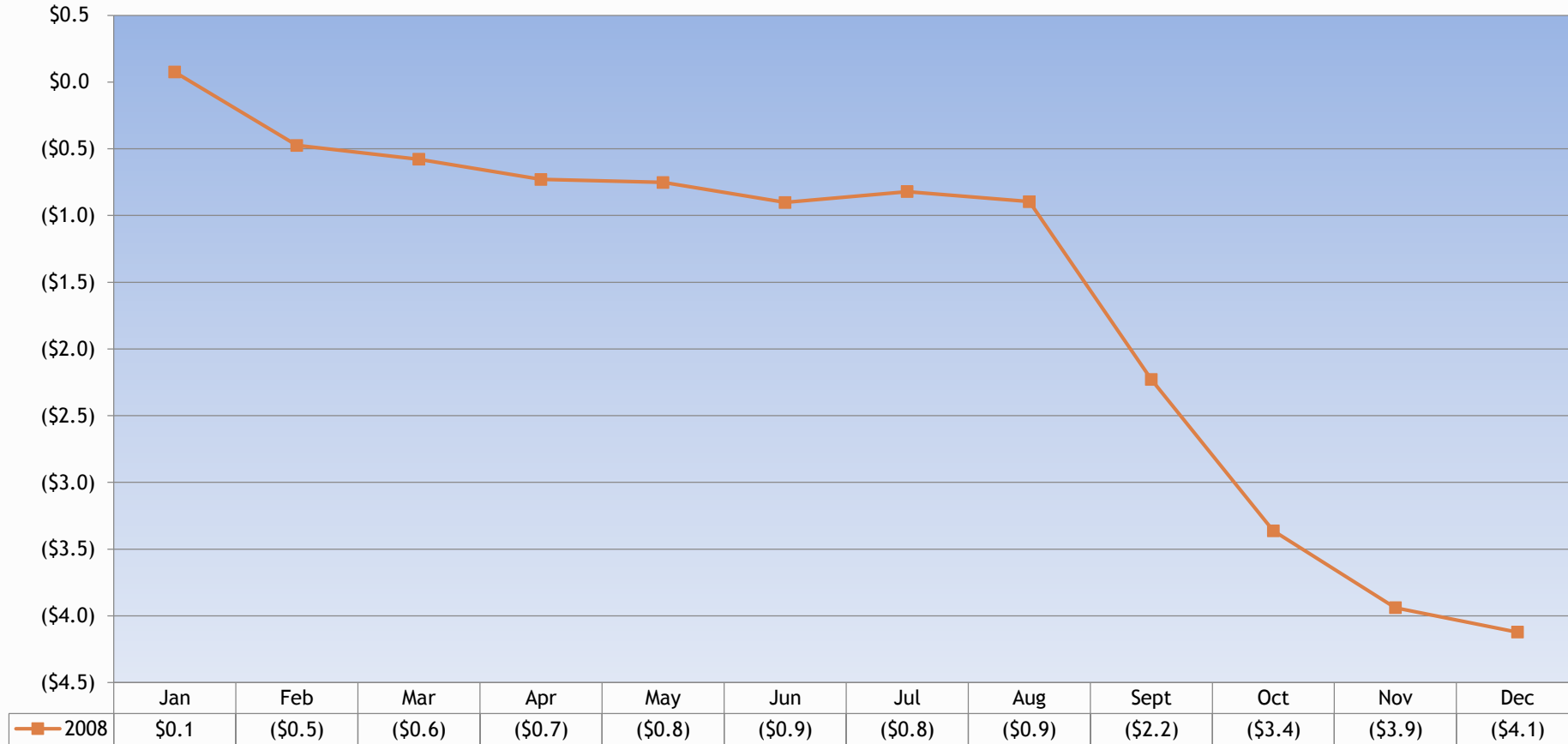
GX-108A through GX-108M
 GX-701 through GX-705

After 9/30: **\$2.0 million**



Z Brokerage Account (Citi/Smith Barney) 2008 Year-to-Date Change in Portfolio Value

GX-108A through GX-
108M
(\$'s IN MILLIONS)



— 2008

After 9/30: **(\$1.9 million)**



Conviction & Forfeiture

- Conviction:

- Found Guilty on these offenses:

- Title & Section 18/USC 371- Conspiracy to make false statements to influence Bank Action on a loan.
 - Title & Section 18/USC 1014- False Statements to Influence Bank Action on a Loan.



- Forfeiture



- \$1,000,000 “MONEY JUDGEMENT” filed against the defendant- at the United States District Court- Southern District of New York (12 CR.288)



International Standards Governing Shell Companies

- The Financial Action Task Force (FATF), the world standard setter and enforcer of anti-money laundering standards

“Countries should take measures to prevent the misuse of legal persons [companies] for money laundering or terrorist financing. Countries should ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or assessed in a timely fashion by competent authorities.”



Other Measures Taken to Eliminate Anonymous Companies

- The UK has established a public beneficial ownership information for all UK companies.
- The European Parliament voted in March 2014 to create a similar registry for all EU companies and trusts, but further action by the EU commission and European Council is pending.
- All companies should be required to disclose their ultimate, beneficial owner when they are created. This information should be listed in a central registry.



U.S. Policies on Beneficial Ownership

- On May 4, 2016, Financial Crimes Enforcement Network (FinCEN) issued its final rule on beneficial ownership with respect to customer due diligence.
- The initial four pillars of the USA Patriot Act:

Policies,
procedures, and
internal controls

Independent
testing

Designated
compliance
official

Employee
training



Fifth Pillar



Establish risk-based procedure for conducting ongoing customer due diligence

Development of customer risk profiles

Implementation of ongoing monitoring to identify and report suspicious activity

Use risk basis to update customer information.



Summary: The Web of Shells



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