



GLOBAL FINANCIAL INTEGRITY

As Strong as the Weakest Link:

Company Registration and
Money Laundering
Vulnerabilities in Latin America

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INTRODUCTION |

This report, which focuses on the five largest¹ economies in Latin America – Mexico, Colombia, Brazil, Argentina, and Chile – analyzes how corporate structures can be exploited for money laundering or other financial crimes. Specifically, it considers the safeguards in place to stop bad actors from creating anonymous companies that could be used for illicit purposes, and whether these safeguards are adequate.

This report is part of a larger effort by Global Financial Integrity (GFI) to analyze vulnerabilities in corporate structures. In 2019, GFI published a report² showing that in the United States, it is easier to establish an anonymous company than it is to register for a library card. The United States is an important jurisdiction since more corporations – anonymous and public – are established there each year than anywhere else.³ While company formation is big business for states, the dark side of anonymous entities is readily apparent, this report found. In addition to tax evasion and shady campaign contributions, US-based shell companies have been used to hide the proceeds of everything from cigarette smuggling to weapons dealing.⁴ Despite these risks, states require little information about who really owns⁵ a company, where it is located, and who its directors or officers are. New legislative developments in the US regarding beneficial ownership transparency will address many, though certainly not all, of these vulnerabilities.

Latin American countries also face challenges in terms of anonymous companies and illicit financial flows (IFFs), though they are somewhat different in nature. In the US context, little information is requested, and few steps required, to start a company. In Latin America, countries generally have much longer and more complex processes with sizable information requirements. Unfortunately, the information that is requested doesn't necessarily lead to greater transparency and security. In many cases, countries are requesting a plethora of information from the person registering the company – oftentimes a lawyer – but little about its true or “beneficial” owner, a person of much greater importance from an anti-money laundering/countering the financing of terrorism (AML/CFT) perspective. Similarly, since the information requested is seldom verified for accuracy, it is of limited utility in terms of preventing, detecting, or investigating financial crimes.

This report also analyzes real cases from the countries in question to see the mechanisms being used to move illicit funds. Anonymous corporate structures are one of many methods used to store, move, launder and reinvest illicit funds. They are often used in contexts when things cannot be done in broad daylight because of law enforcement and regulatory controls. Yet in situations where law enforcement and regulators have limited presence, capacity, resources, or integrity, the use of anonymous companies may not be necessary. Instead, those who wish to move these funds can bribe an official, drive across a porous border, or rely on a friend in politics to get the job done.

¹ See World Bank Data, Gross Domestic Product (Current USD), 2018. Available at: https://data.worldbank.org/indicator/NY.GDP.MKTP.CD?end=2018&most_recent_value_desc=false&start=2018&view=bar

² “The Library Card Project: The Ease of Forming Anonymous Companies in the United States,” Global Financial Integrity, March 2019. Available at: <https://secureservercdn.net/45.40.149.159/34n.8bd.myftpupload.com/wp-content/uploads/2019/03/GFI-Library-Card-Project.pdf?time=1580495391>

³ “The Library Card Project: The Ease of Forming Anonymous Companies in the United States,” Global Financial Integrity, March 2019. Available at: <https://secureservercdn.net/45.40.149.159/34n.8bd.myftpupload.com/wp-content/uploads/2019/03/GFI-Library-Card-Project.pdf?time=1580495391>

⁴ Leslie Wayne, “How Delaware Thrives as a Corporate Tax Haven,” New York Times, June 30, 2012. Available at <https://www.nytimes.com/2012/07/01/business/how-delaware-thrives-as-a-corporate-tax-haven.html>

⁵ This concept is referred to as Beneficial Ownership. The Beneficial owner is the person or persons who directly or indirectly own or control the company.

Just as crimes, such as drug trafficking or human trafficking, move across borders and involve multiple jurisdictions, so too do the financial crimes associated with them. In the Chilean case (see pp.33, for example), complex corporate structures spanned from Texas and Miami to the capital city of Santiago, with illicit gold exports reaching as far as the United Arab Emirates. The problem is that the corporate registration process provides a guise of legitimacy and respectability: an illicit company, having gone through the required steps, can go on to engage with local, national and international markets with relative ease.

The scope of this report is limited in several ways. To begin with, its focus is on corporate formation requirements at the national level, rather than the state or municipal level. However, it should be noted that important local differences do emerge, particularly as pertain to corruption and state capture. Moreover, in countries with federal structures, such as Mexico, Argentina and Brazil, many of the corporate formation steps occur at the state level. While a state-level analysis is beyond the scope of this report, it represents an interesting and important area for future research. The research and analysis for this report was conducted during the course of 2019 and 2020 and some countries may have adopted legal or regulatory changes since that time.

In addition, this report is intentionally limited in focus to corporate formation requirements, and does not consider other requirements that may come into play. In some instances, corporate entities face additional requirements in order to sign contracts, lease office space, open bank accounts or move funds. They may be required to present additional forms of identification, for example, or to go through additional verification processes to ensure that information presented was accurate. In some cases, they may be required to present information on the real person behind the company, the so-called “beneficial owner.” While these subsequent requirements may help to reduce financial risks, it is important to recall that not all corporate entities go on to do these steps, particularly within the Latin American and Caribbean context. Therefore, the company registration process alone should be sufficiently transparent and robust so as to prevent the creation of illicit shell companies or front companies.

In terms of its methodology, this report analyzed laws and regulations from each of the five countries in question. To complement this legal review, it also drew on information from other sources, such as government publications and websites, reports by multilateral organizations such as the World Bank and GAFILAT, and research by civil society groups working on these issues.

As such, it is important to consider stronger, more transparent policies for business registration as part of a national and international security strategy. For the Latin American countries in question, it is not a matter of requesting more information, but rather, of requesting more targeted and pertinent information, as well as conducting verification for accuracy. For countries balancing a desire to promote entrepreneurship with a need to ensure security, this approach will not place undue burden on legitimate businesses but will ensure that law enforcement have the tools to prevent, detect and investigate financial crimes.

KEY CONCEPTS AND TERMS |

The corporate formation process is complex and involves a number of technical concepts as well as national stakeholders. At the same time, analyzing this process for financial crime vulnerabilities requires its own set of technical concepts. In order to make this report more accessible, a list of key terms and vocabulary is provided below.

Key Terms

Anonymous Companies: An anonymous shell company is a corporate entity that has disguised its ownership in order to operate without scrutiny from law enforcement or the public.⁶

Beneficial Ownership: Beneficial owner is the technical term for the real people who ultimately own or control a company, even if there are layers of companies in between that “own” and the next company down the chain.⁷

Corporation: Sometimes called a “legal person,” a corporation is a legal entity with its own rights and responsibilities. These include the right to enter into a contract or have a bank account, for example, or the responsibility to pay taxes or be held liable in the event of a lawsuit. The rights and responsibilities of a corporation are distinct from the rights and responsibilities of the people who own it.⁸

Corporate Formation: The process of creating and registering a corporation.

Financial Action Task Force: The Financial Action Task Force (FATF) is the global money laundering and terrorist financing watchdog. The inter-governmental body sets international standards that aim to prevent these illegal activities and the harm they cause to society. As a policy-making body, the FATF works to generate the necessary political will to bring about national legislative and regulatory reforms in these areas.

Grupo de Acción Financiera de Latinoamérica (GAFILAT), a regional body of FATF. Its members include Argentina, Brazil, Chile, Colombia and Mexico, the countries of focus for this report.⁹

Illicit financial flows (IFFs): Illicit financial flows (IFFs) are illegal movements of money or capital from one country to another. GFI classifies this movement as an illicit flow when funds are illegally earned, transferred, and/or utilized across an international border.¹⁰

Money laundering (ML): Money laundering is the process of disguising the proceeds of crime and integrating it into the legitimate financial system. Before proceeds of crime are laundered, it is problematic for criminals to use the illicit money because they cannot explain where it came from and it is easier to trace it back to the crime. After being laundered, it becomes difficult to distinguish money from legitimate financial resources, and the funds can be used by criminals without detection.¹¹

⁶For more information, see “Issues: Anonymous Companies,” Global Financial Integrity. Available at: <https://gfintegrity.org/issue/anonymous-companies/>

⁷For more information, see “Issues: Anonymous Companies,” Global Financial Integrity. Available at: <https://gfintegrity.org/issue/anonymous-companies/>

⁸For a good description, see <https://www.investopedia.com/terms/c/corporation.asp>

⁹See <https://www.gafilat.org/index.php/es/>

¹⁰For more information, see “Issues: Illicit Financial Flows,” Global Financial Integrity. Available at: <https://gfintegrity.org/issue/illicit-financial-flows/>

¹¹For more information, see “Issues: Money Laundering,” Global Financial Integrity. Available at: <https://gfintegrity.org/issue/money-laundering/>

Spanish and Portuguese Language Terms

Sociedad Anónima (Spanish) and Sociedade Anônima (Portuguese): This translates to Anonymous Society. While the specific terms of the Sociedad Anónima depend on the country, for US readers, it may be helpful to think of this as similar to a publicly held company or corporation. In general terms, ownership is based on shares of stock. It is sometimes abbreviated in Spanish or Portuguese as S.A.

Sociedad de Responsabilidad Limitada (Spanish) and Sociedade de Responsabilidade Limitada (Portuguese): Limited Responsibility Society. The exact characteristics of this type of corporate structure depend on the country where it is located. In very general terms, however, it is similar to a US Limited Liability Company (LLC), a private company in which the corporate structure itself assumes responsibility for debts or lawsuits (so that the people who own it are not liable). It is sometimes abbreviated as SRL.

Other Terms and Abbreviations Used

AML/CFT: Anti-Money Laundering and Counter Terrorism Financing

CNPJ: Cadastro Nacional de Pessoas Jurídicas, the National Registry of Legal Entities of Brazil

DIAN: Dirección de Impuestos y Aduanas Nacionales, the Colombian Tax and Customs Authority

EIRELI: Empresa Individual de Responsabilidade Limitada, the Individual Limited Liability Company of Brazil

FATF: Financial Action Task Force

FIU: Financial Intelligence Unit

GAFILAT: Grupo de Acción Financiera de Latinoamérica, the Financial Action Task Force of Latin America

GDP: Gross Domestic Product

IMSS: Instituto Mexicano de Seguridad Social, The Mexican Institute of Social Security

OECD: the Organization for Economic Cooperation and Development

OFAC: Office of Foreign Assets Control, part of the US Treasury

PPP: Purchasing power parity

RNIE: Registro Nacional de Inversión Extranjera, the Mexican National Registry of Foreign Investment

RUES: Registro Único Empresarial, the Unique Business Registry

SAT: Servicio de Administración Tributaria, the Tax Administration Service

STRs: Suspicious Transaction Reports

COUNTRIES OF FOCUS |

This report focuses on Mexico, Colombia, Brazil, Argentina and Chile as the five largest economies in Latin America. As can be seen in the table below, these are large economies that nonetheless have high levels of poverty, inequality, and informality. Though conditions vary from country to country, corruption is an important issue for many of them.

While a larger discussion of economic trends in these countries is beyond the scope of this report, the table below provides a brief overview as context.

Table 1: Key Country Indicators

| Country | GDP in Current US\$ (Millions) | GDP per Capita in Current US\$ | Population | Population living on less than \$5.50/day (% population, 2011 PPP) | Account with financial institution or mobile money provider (% Pop.) | GINI index (Higher indicates greater inequality) | Informal Employment (% of total non-Agricultural employment) | Corruption Perceptions Index (Higher indicates less corrupt) |
|-----------|--------------------------------|--------------------------------|-------------|--|--|--|--|--|
| Mexico | 1,258,287 | 9,863 | 127,576,000 | 23 | 36.93 | 45.4 | 61 | 29 |
| Colombia | 323,803 | 6,432 | 50,339,000 | 28 | 45.76 | 50.4 | 57 | 37 |
| Argentina | 449,664 | 10,006 | 44,939,000 | 10 | 48.71 | 41.4 | 49 | 45 |
| Brazil | 1,839,758 | 8,717 | 211,050,000 | 20 | 70.04 | 53.9 | 38 | 35 |
| Chile | 282,318 | 14,897 | 18,952,000 | 4 | 74.35 | 44.4 | 28 | 67 |

Sources: For all GDP, population, poverty, financial inclusion and inequality data, World Bank Data, most recent year available. Accessed August 2020. For corruption data, Transparency International's 2019 Corruption Perceptions Index.

Graphic 1: Countries of Focus





MEXICO

In Mexico, there are many links between shell companies and illicit activities. A common thread in these cases is the use of shell companies to provide a veneer of respectability and legality for proceeds coming from illegal activities such as corruption, drug trafficking and human trafficking.

Mexico's 2018 Mutual Evaluation Report for the FATF indicates that one of the most common methods of money laundering in Mexico involves the use of shell and front companies. The report notes that "the most widespread phenomenon is the misuse of shell and front companies to perpetrate predicate offences, such as self-dealing, embezzlement and tax evasion, as well as to invest illicit proceeds from organized criminality and corruption in real estates, restaurants, shops and other businesses either in Mexico, the US, or other foreign countries."¹²

The case of the "Fake Companies of Veracruz"

In the Mexican state of Veracruz, for example, members of the Javier Duarte Administration used shell companies to divert at least 645,693,000 pesos (US\$48 million) from public funds during the period 2012-2013. Government officials signed 73 public contracts for the acquisition and distribution of public goods as part of social programs intended to help children, the elderly and victims of natural disasters. However, an excellent in-depth investigation by Animal Politico documented that these businesses were created under false pretenses and registered to fake addresses. Moreover, many of the purported owners of these businesses were simply local people of limited resources, who had no practical connection to the business itself. In one instance, the company Abastecedora Romcru S.A. de C.V. earned 180,913,832 pesos, or roughly US\$8.2 million, in government contracts, listing as its owner a man who in reality was a local street musician living in a humble shanty. According to the investigation, he had never heard of the business.

Source: Arturo Angel and Victor Hugo Artega, "The Fake Companies of Veracruz," an in-depth journalistic investigation by Animal Politico, May 2016. Available at: <https://www.animalpolitico.com/las-empresas-fantasma-de-veracruz/entrada.php?slug=la-revelacion&id=392293> and <https://www.animalpolitico.com/las-empresas-fantasma-de-veracruz/entrada.php?slug=la-revelacion&id=392493>

In many of these cases, companies have gone through the business registration processes required by Mexican law, but have managed to hide and manipulate information. This raises the question: what is the process for corporate formation in Mexico and where are the loopholes that illicit actors are using to their advantage?

Country Context

There are 5.4 million companies registered in Mexico, according to data published by the Instituto Nacional de Estadística y Geografía.¹³ By sheer numbers, it comes as no surprise that the state of Mexico, with a population of over 16 million inhabitants, leads in business registration. In relation to number of inhabitants, the states of Tlaxcala and Oaxaca have the most registered businesses. By sector, the retail industry has the largest number of registered businesses.

¹²"Anti-Money Laundering and Counter-Terrorist Financing Measures in Mexico: Mutual Evaluation Report," FATF and GAFILAT, January 2018. Page 5. Available at: <https://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-Mexico-2018.pdf>

¹³"Directorio Estadístico Nacional de Unidades Económicas," Instituto Nacional de Estadística y Geografía (INEGI) Available at: <https://www.inegi.org.mx/temas/directorio/default.html#Metadatos>

Informality remains a significant challenge for Mexico, and the total number of enterprises is no doubt much larger than the number of formally registered companies. Half of Mexico's Gross Domestic Product (GDP) comes from the informal sector,¹⁴ and 53.4 percent of Mexican workers are currently in informal labor situations, as defined by the International Labor Organization.¹⁵ Moreover, Mexico has one of the lowest formal company registration rates in Latin America, with only 0.5 formal registrations per 1,000 working age residents, less than half the regional average.¹⁶

Mexican Legal Framework

The main legal framework for companies in Mexico is the Ley General De Sociedades Mercantiles, first passed in 1934 and most recently amended in 2018.¹⁷ A major change to the law included the creation of a new type of company, the Sociedad por Acciones Simplificada (SAS), in 2016. The SAS offers a simplified registration framework as part of efforts to promote the formalization of the informal sector in Mexico, which has been a persistent challenge.

Mexican law lays out seven corporate structures:

- Sociedad en Nombre Colectivo
- Sociedad en Comandita Simple
- Sociedad de Responsabilidad Limitada
- Sociedad Anónima
- Sociedad en Comandita por Acciones
- Sociedad Cooperativa
- Sociedad por Acciones Simplificadas (SAS)

Each type of company has a unique structure, as well as somewhat distinctive requirements for formation and registration. This report will analyze the three most common types of commercial companies in Mexico, which are Sociedad de Responsabilidad Limitada, Sociedad Anónima and Sociedad por Acciones Simplificadas. The following table presents a brief overview of their main characteristics:

¹⁴Andres Rozental, "How Much is Informality Holding Back Mexico's Economy?" The Latin America Advisor, a publication of the Inter-American Dialogue, June 19, 2014. Available at: <https://www.brookings.edu/opinions/how-much-is-informality-holding-back-mexicos-economy/>

¹⁵"Women and Men in the Informal Economy: A Statistical Picture," International Labor Organization (ILO), 2018. Available at: https://ilo.userservices.exlibrisgroup.com/view/delivery/41ILO_INST/1252879760002676

¹⁶World Bank Data, New business density (new registrations per 1,000 people ages 15-64), 2016 or most recent value. Available at: <https://data.worldbank.org/indicator/IC.BUS.NDNS.ZS>

¹⁷Ley General de Sociedades Mercantiles, Texto Vigente. Available at: http://www.diputados.gob.mx/LeyesBiblio/pdf/144_140618.pdf

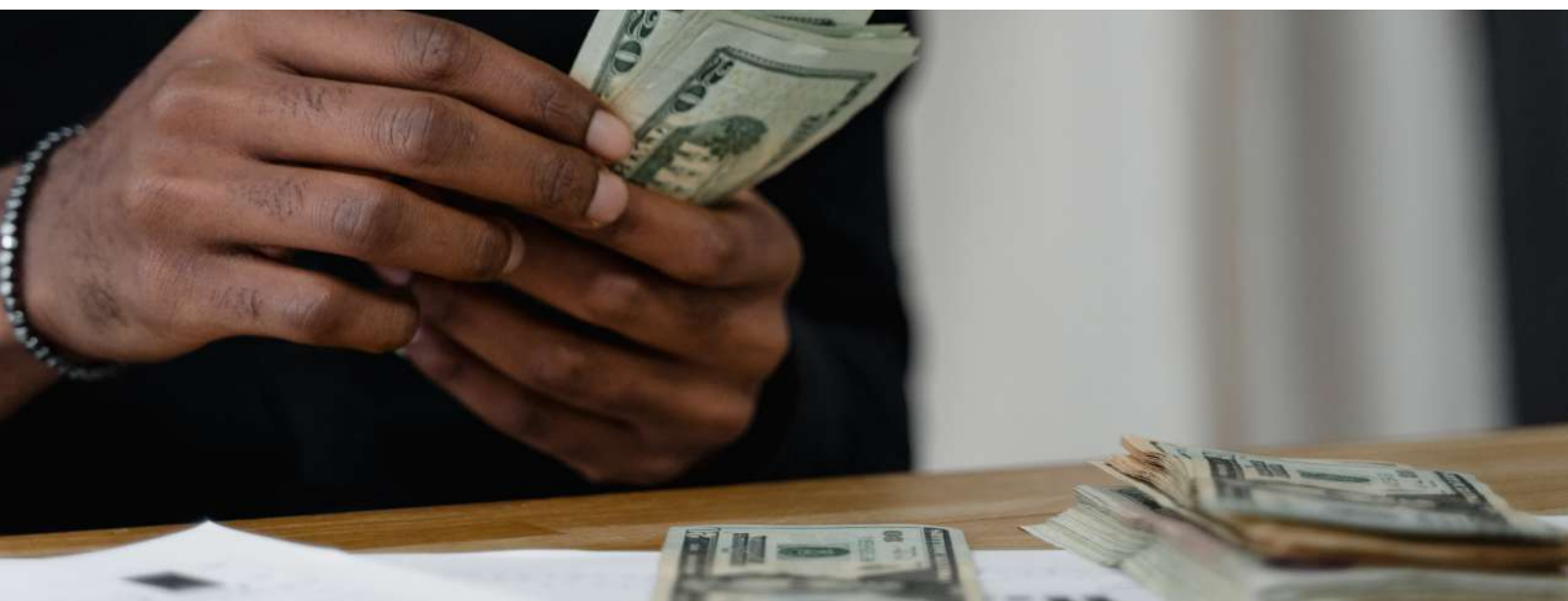


Table 2: Characteristics of Principal Corporate Structures in Mexico

| | Sociedad de Responsabilidad Limitada | Sociedad Anónima | Sociedad por Acciones Simplificada |
|------------------------|---|---|---|
| Capital requirements | The minimum capital is established by the shareholders | The minimum capital is established by the shareholders | Maximum annual income of five million pesos ¹⁸ |
| Number of Shareholders | Two-50 | Minimum of two | One or more partners. Cannot have management role in another type of company. |
| Shareholder liability | Shareholders' liability is limited to their capital investment. | Shareholders' liability is limited to their capital investment. | Partners' liability is limited to their capital investment |
| Management | Must be managed by Administrators or Board of Directors | Must be managed by Administrators or Board of Directors | No restrictions |
| Legal/Physical Persons | Partners can be legal or physical persons | Partners can be legal or physical persons | Partners must be physical persons (cannot be legal entities) |
| Registration process | Standard | Standard | Simplified |

Sources: Ley General De Sociedades Mercantiles, Current Text as Amended 6/14/2018. Available at: <http://www.cnsf.gob.mx/CUSFELECTRONICA/CUSF/Viewer?filePath=LGSM.pdf> and "Características de las SAS," Secretaría de Economía de Mexico. Available at: https://www.gob.mx/cms/uploads/attachment/file/224475/2.2.2_Sociedad_por_Acciones_Simplificada__SAS_.pdf



Registering a Company in Mexico

There are typically six steps to register a company in Mexico, though the process is simplified for the SAS due to their small size. The main government entities and agents involved in this process are the Secretaría de Economía, Mexican Notary Publics, the Servicio de Administración Tributaria (SAT), the Registro Público de la Propiedad y del Comercio, the social security administration and local tax authorities. It is important to note that the Notary Publics have a very prominent role in company formation and registration, which is problematic due to issues with corruption,¹⁹ high costs²⁰ and inconsistent quality.²¹

¹⁸ If the society's annual income surpasses this threshold, it must convert into another type of society.

¹⁹ For examples, see

<https://www.animalpolitico.com/2016/05/entre-los-notarios-que-legalizaron-las-empresas-de-veracruz-hay-diputados-del-pri-e-hijos-de-funcionarios-de-duarte/> or <https://www.animalpolitico.com/2019/07/collado-red-notarios-empresarios/>

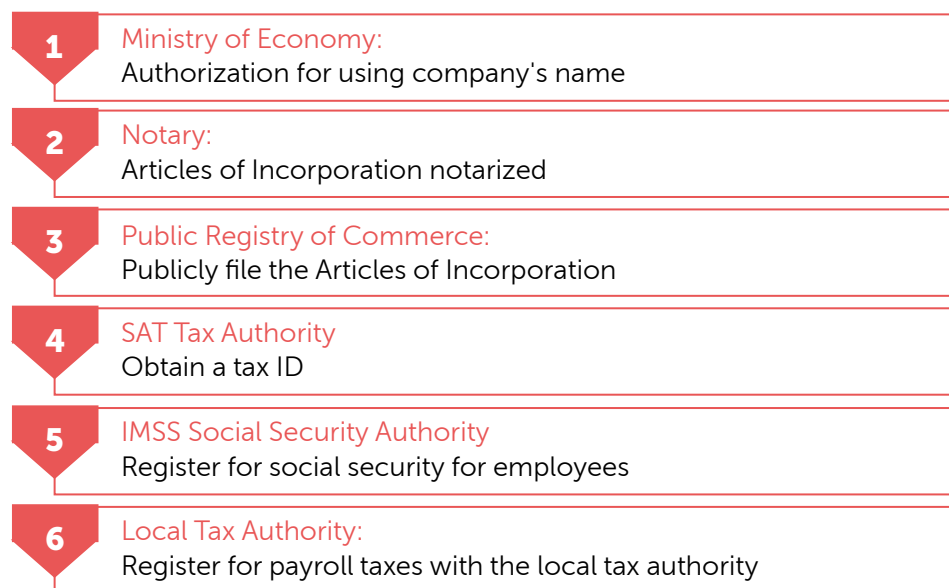
²⁰ Ollin Velasco, "El negocio de las notarías en México: ¿Por qué es tan caro hacer un testamento o escritura?" Vice Mexico, October 31, 2017. Available at:

https://www.vice.com/es_latam/article/bj7mev/vice-news-el-negocio-de-las-notarias-en-mexico-por-que-es-tan-carro-hacer-un-testamento-o-es-criurar

²¹ Cinthya Paola Orozco Gomez and Fabiola Navarro Luna, "Requisitos legales para el nombramiento de notario público," Universidad Nacional Autónoma de México, 2019. Available at:

<https://oci.juridicas.unam.mx/detalle-herramientas/54/requisitos-legales-para-el-nombramiento-de-notario-p%C3%BAblico>

Graphic 2: Steps to Creating and Registering a Corporate Entity in Mexico



Source: Global Financial Integrity elaboration of process.

The registration process is intended to check for unique business names, ensure the formality of the articles of incorporation and link the new business with the tax, social security and social benefits authorities. The process typically takes eight days and costs 15.2 percent of per capita income.²²

Vulnerabilities in the Business Formation Process

On the one hand, the Mexican business formation process has several safeguards in place. It attempts to collect information on businesses, at least to a certain extent, at each stage in the process. For example, the Mexican State of Jalisco informed that the business registration must be presented in person and that only a physical address would be accepted, not a PO Box.²³ Moreover, the use of Notary Publics, who have AML/CFT obligations, as well as record-keeping and reporting responsibilities, may provide certain safeguards. Finally, Mexican law correctly recognizes the need for simplified structures for lower-income and smaller businesses, in what is a laudable attempt to address longstanding issues of informality. After all, informal businesses present risks as well, and the Mexican government has far fewer mechanisms to monitor them.

On the other hand, the process presents weaknesses with regards to a) verification; b) information backlogs and updates; c) corruption; d) variation among state requirements; e) foreign legal entities; f) nominee shareholders; and g) determination of beneficial ownership, particularly in a context where legal representatives and third-parties have wide-ranging abilities.

To start with, verification of the information presented is often inadequate. As the previous example from the State of Veracruz indicates, something is not working properly if unscrupulous actors are able to register businesses to false addresses and unknowing persons without official detection. Even a measure as simple as checking the listed address against Google Maps could raise red flags in some instances.

²²"Economy Profile: Mexico," Doing Business 2020, The World Bank Group. Available at: <https://www.doingbusiness.org/content/dam/doingBusiness/country/m/mexico/MEX.pdf>

²³Information query with the State of Jalisco, Colaboracion.jalisco.gob.mx, "Atención al Contribuyente," December 12, 2019.

Information that is outdated, or backlogged is a common theme in terms of Mexican corporate formation and presents a serious risk, even according to Mexico's own National Risk Assessment.²⁴ To cite a few examples:

- Though the Registro Público de Comercio is now operational at a federal level, it was previously managed by the states. There are six states with a backlog of companies created before September 2016 that had not been entered into the Federal register as of 2018.²⁵
- In the case of shareholder registries, "there are no specific sanctions foreseen for failures to maintain a register of shareholders, or members and update it accordingly (for legal persons)."²⁶
- "As financial institutions are not required to update non-high-risk-customers' files unless a change in behavior is detected, the extent to which customer profiles are up to date is uncertain."²⁷
- When the notary collects general information about partners or shareholders, she collects information on their capital, residency, tax obligations and beneficial ownership. However, if there is a change in this information, it is not obligatory to report it.²⁸

Access to information by law enforcement is a mixed bag. On the one hand, the Mexican Financial Intelligence Unit has direct, online access to a variety of pertinent information on corporations registered.²⁹ However, it does not often have adequate access to databases maintained by law enforcement authorities, such as criminal information records.³⁰

Moreover, corruption is a major concern. The checks in place within the corporate registration system are ineffective if those who are administering the system are corrupt themselves. In the initial example cited, a former governor was assisted by a range of corrupt public civil servants, as well as corrupt notaries who registered and certified illicit shell companies. In many Mexican states, the governor appoints notary publics, a privilege that is often bestowed on friends and allies. The "favoritism" in this position make it vulnerable to manipulation by illicit actors.³¹ As such, their ability to do due diligence is severely compromised.

Mexico, with its federal structure, leaves certain discretion to states in terms of corporate formation, which creates vulnerabilities for AML/CFT. Mexican states such as Nuevo Leon and Sinaloa are among those with the most streamlined procedures for registering a business,³² while they also appear on the top of the list of Office of Foreign Asset Controls (OFAC) mentions by Mexican state.³³ Meanwhile, Jalisco, another state that tops the list of OFAC mentions, has been described by Mexican researchers as a place where "no one sees anything, no one investigates, no one comments, no one goes against the drug kingpins, no one is afraid."³⁴

²⁴Mexican National Risk Assessment, 2016. "Lack of updated information on shareholder and controller registries of moral persons" is identified as a medium impact, medium probability risk in terms of judicial effectiveness on cases related to illicit financial flows. See page 29.

²⁵"Anti-Money Laundering and Counter-Terrorist Financing Measures in Mexico: Mutual Evaluation Report," FATF and GAFILAT, January 2018. Page 5. Available at: <https://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-Mexico-2018.pdf>

²⁶"Anti-Money Laundering and Counter-Terrorist Financing Measures in Mexico: Mutual Evaluation Report," FATF and GAFILAT, January 2018. Page 5. Available at: <https://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-Mexico-2018.pdf>

²⁷"Anti-Money Laundering and Counter-Terrorist Financing Measures in Mexico: Mutual Evaluation Report," FATF and GAFILAT, January 2018. Page 5. Available at: <https://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-Mexico-2018.pdf>

²⁸Mexican National Risk Assessment, 2016. Available at: <https://www.pld.hacienda.gob.mx/work/models/PLD/documentos/enr.pdf> See pg 32.

²⁹As per Mexico's most recent Mutual Evaluation Report, this includes "Direct online access to information from the Ministry of Economy on corporations registered (registry page, company name, state, municipality, address, date of incorporation, corporate purpose, partners or shareholders, share capital, and type of capital) and from the partners or shareholders (number of shares) available in the Public Registry of Commerce." See <https://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-Mexico-2018.pdf> Footnote 102.

³⁰"Anti-Money Laundering and Counter-Terrorist Financing Measures in Mexico: Mutual Evaluation Report," FATF and GAFILAT, January 2018. Page 5. Available at: <https://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-Mexico-2018.pdf> See page 199.

³¹Gardenia Mendoza, "Notarios, pieza clave en la corrupción de los gobernadores de México," La Opinión, April 17, 2017. Available at: <https://laopinion.com/2017/04/17/notarios-pieza-clave-en-la-corrupcion-de-los-gobernadores-de-mexico/>

³²World Bank, Doing Business "Subnational Economy Rankings – Mexico," 2016. Available at: <https://www.doingbusiness.org/en/rankings/mexico>

³³Of 727 geographic mentions by Mexican State, Sinaloa was in second place with 135 mentions and Nuevo Leon was in 10th place with 12 mentions. See <https://sanctionssearch.ofac.treas.gov/>

³⁴"Jalisco: Paraíso del blanqueo de dinero del narcotráfico" Debate, August 15, 2017. Available at:

<https://www.debate.com.mx/mexico/Jalisco-Paraíso-del-blanqueo-de-dinero-del-narcotráfico-20170815-0377.html>

Corporate structures formed out of foreign corporate structures^{35 36} present another vulnerability, since it becomes difficult to track the true origin or destination of funds. Several types of corporate structures in Mexico can be created by foreign corporate structures, which would be used as vehicles to move illicit funds, especially in the absence of a robust beneficial ownership policy. However, Mexican law requires Mexican corporate structures with one or more foreign owners to register with the Registro Nacional de Inversión Extranjera (RNIE), which is updated annually, and contains their names, nationality, domicile and percent ownership. Likewise, foreign corporations must also register with RNIE, providing information that identifies them and proving they were properly incorporated in their home jurisdiction.³⁷ Though neither the Mexican National Risk Assessment, nor the most recent Mutual Evaluation report identify foreign-owned corporate structures as a top area of concern, it nonetheless is an area worth monitoring.

Another weakness is the failure to identify the beneficial owner, that is to say, the real person or persons who ultimately control and benefit from the company.³⁸ This is a significant risk for Mexico, as identified in its 2018 Mutual Evaluation:

“The amount of proceeds generated by predicate crimes committed in and outside of Mexico is high. The main domestic proceeds-generating crimes can be divided into three tiers of magnitude: (i) domestic organized crimes, including drugs and human trafficking, (ii) corruption, and (iii) tax evasion. The country also faces particular risks related to the laundering of proceeds derived from foreign predicate crimes mostly related to Mexican transnational organized crime (...) Typical ML methods include the use of shell and front companies to conceal beneficial ownership (BO), the purchase and sale of real estate and high-value goods, and cash smuggling on both directions of the US–Mexico Border. The high use of cash and relatively large informal economy significantly increases the risk that illicit proceeds may be re-channeled into the regulated formal economy.”³⁹

In this sense, it is concerning that beneficial ownership is not requested during the corporate formation process. While the SAS structure may be less at risk because it can only be formed by physical persons and its incomes are capped, other structures such as the SRL and the SA are more vulnerable. Mexico has announced it intends to create a beneficial ownership registry in the future, but it is not expected to be ready before 2022 or 2023 and implementation details are not yet available.⁴⁰

³⁵The requirements for this process can be seen here,

<https://www.gob.mx/se/acciones-y-programas/autorizacion-para-establecer-en-mexico-personas-morales-extranjeras-se-02-010?state=published>

³⁶The main requirements for foreign corporate structures in Mexico are: 1) Demonstrating that they are legally constituted according to the laws of their country; 2) That their constitutive documents are not contrary to public order, as defined by Mexican law; and 3) If they are regularly to conduct business in Mexico, that they establish an agency or branch in Mexico. For more information, see https://www.ijf.cjf.gob.mx/Sitio2016/include/sections/MICROSITIOS_Propuesta/DeProfesores/La%20personalidad%20de%20las%20empresas%20e%20extranjeras.pdf

³⁷Peer Review Report, Phase 2, Implementation of the Standard in Practice, Mexico,” Global Forum on Transparency and Exchange of Information for Tax Purposes, OECD, 2014. Available at: <http://www.eoi-tax.org/jurisdictions/MX#latest>

³⁸According to the FATF definition, “Beneficial owner refers to the natural person(s) who ultimately owns or controls a customer and/or the natural person on whose behalf a transaction is being conducted. It also includes those persons who exercise ultimate effective control over a legal person or arrangement.” See <https://www.fatf-gafi.org/glossary/>

³⁹“Anti-Money Laundering and Counter-Terrorist Financing Measures in Mexico: Mutual Evaluation Report,” FATF and GAFILAT, January 2018. Page 5. Available at: <https://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-Mexico-2018.pdf>

⁴⁰Ariadna Ortega, “México se une a convención para identificar beneficiarios finales de corrupción,” Expansion, December 9, 2019. Available at: <https://politica.expansion.mx/mexico/2019/12/09/mexico-se-une-a-convencion-para-identificar-beneficiarios-finales-de-corrupcion>

Particularly considering the lack of beneficial ownership information, the presence of nominee shareholders, or nominee directors in Mexico is concerning. While Mexico's GAFILAT Mutual Evaluation report states that Mexico does not allow nominee shareholders or nominee directors,⁴¹ other sources indicate that it does.⁴² In an Organization for Economic Co-operation & Development (OECD) report, it is noted that "there is no provision in Mexican law that prohibits a person from holding shares in a company in his or her name but on behalf of a person based on a contractual arrangement."⁴³ Moreover, the E-Certificate form issued by the tax authority requests information on company shareholders and their legal representatives, but it does not request disclosure if those shares are owned on behalf of a third party. This arrangement is called a "Mandato sin representación" under Mexican law.⁴⁴ A similar legal concept in Mexican law is the "Comitente oculto," under Article 273 of the Code of Commerce.⁴⁵ Corporate structures such as the SRL and the SA are at risk for unscrupulous third-party shareholders.

⁴¹GAFILAT Mutual Evaluation Report on Mexico, January 2018. The report states "las acciones nominativas y los directores dominicales no están permitidos en México," translated as "Bearer shares, nominee shares, and nominee directors are not allowed in Mexico." See <https://www.fatf-gafi.org/publications/mutualevaluations/documents/mer-mexico-2018.html>

⁴²See, for example, "G-20 Anti-Corruption Working Group: Guide to Beneficial Ownership Information: Legal Entities and Legal Arrangements," The World Bank, October 2016. Available at: <https://star.worldbank.org/content/beneficial-ownership-guides> See also "Mexico Beneficial Ownership Transparency," Transparency International, 2015.

⁴³"Peer Review Report, Phase 2, Implementation of the Standard in Practice, Mexico," Global Forum on Transparency and Exchange of Information for Tax Purposes, OECD, 2014. Available at: <http://www.eoi-tax.org/jurisdictions/MX#latest>

⁴⁴This is defined as "Through a contract, the mandatary is obliged to execute, on behalf of the client, the legal act(s) that the client charges him with. Upon carrying out these legal acts in from of other persons, he omit saying that he acts as a mandatary, and says that he is acting on his own behalf, of his own will, and in his own name." See Sara Arellano Palafox, "Breve referencia sobre las formas de representación en el derecho civil," Universidad Nacional de México. Available at <https://archivos.juridicas.unam.mx/www/bjv/libros/8/3835/4.pdf>.

⁴⁵This states that "When a mandate is applied to concrete acts of commerce, it becomes a business commission. The Client confers the business commission, and the commissioner carries it out." See http://www.diputados.gob.mx/LeyesBiblio/pdf/3_311218.pdf





COLOMBIA

Colombia has relatively robust systems in place to detect and address illicit financial flows. However, the country faces a very complex security situation in terms of narcotics trafficking, illegal mining, and transnational organized crime.⁴⁶ Moreover, its regional location places it along trafficking routes and next to countries with criminal activity and/or weak institutions, further contributing to the risks Colombia faces.

In this context, the use of corporate structures to move, launder, or reinvest illicit funds is a serious concern. Colombia's 2018 GAFILAT Mutual Evaluation Report notes the need for a "more in-depth ML/TF [money laundering/terrorist financing] threat and vulnerability analysis," that looks at new areas, such as "ML risks associated with corporate vehicles."⁴⁷

The Goldex Case

Several recent cases from the Colombian gold sector illustrate how such corporate vehicles can be abused. In 2015, the Colombian Attorney General announced a case against Goldex, one of Colombia's largest gold exporters, for purchasing illegally obtained gold and then laundering it through a network of fake businesses, many of them Sociedades por Acciones Simplificadas (SAS). According to a statement by the Attorney General's Office, Goldex "created a carousel of legal entities registered to different Chambers of Commerce, purporting to be providers." They noted various red flags, including companies that were rapidly created and then dismantled, or had the same partners' names appearing repeatedly. Other red flags included low capital, but high transaction volumes, and large invoices, but little evidence of the capacity to carry out operations on that scale.

Sources: Santiago Martínez Hernández, "Así se lavaron \$2,3 billones, producto del oro ilegal," El Espectador, January 21, 2015. Available at: <https://www.elespectador.com/noticias/judicial/asi-se-lavaron-23-billones-producto-del-oro-ilegal-articulo-539297>. "Desarticulada red de lavado de dinero a través de exportaciones de oro," Colombian Attorney General's Office, January 16, 2015. Available at: <https://www.fiscalia.gov.co/colombia/noticias/destacada/desarticulada-red-de-lavado-de-dinero-a-traves-de-exportaciones-de-oro/>

⁴⁶For a more detailed analysis of these dynamics, see "Illicit Financial Flows & Colombia," Global Financial Integrity, October 2019. Available at: https://secureservercdn.net/45.40.149.159/34n.8bd.myftpupload.com/wp-content/uploads/2019/10/Colombia-2019_10.4.19.pdf?time=1576152230

⁴⁷"Mutual Evaluation report of Republic of Colombia," GAFILAT, 2018. Available at: https://secureservercdn.net/45.40.149.159/34n.8bd.myftpupload.com/wp-content/uploads/2019/10/Colombia-2019_10.4.19.pdf?time=1576152230
Pgs 11, 29.



The Goldex Case Repeats Itself

A similar case emerged in 2019 with Comercializadora CIJ Gutiérrez, the country's largest gold exporter. The Colombian Attorney General has accused the company of creating a "carrousel of purported providers and sub-providers (...) that were actually shell companies, working under different names from those they were registered under, with little capital, no economic capacity, in debt or bankrupted, however, appearing on paper as the providers of operations worth billions of pesos." Yet another company, CI Metales Hermanos, a Colombian gold exporter, is now under investigation for exporting 1.9 tons of gold from questionable sources from 2009-2015. According to the Attorney General's Office, they operated through "shell companies and fraudulent transactions with indigenous communities and deceased people."

Sources: Olga Patricia Rendón M., "Fiscalía está tras red ilegal de oro," *El Colombiano*, April 12, 2019. Available at: <https://www.elcolombiano.com/colombia/fiscalia-esta-tras-red-ilegal-de-oro-LH10534807>. "2.4 billones de pesos fueron blanqueados en operaciones ficticias de compra y venta de oro," Colombian Attorney General's Office, April 11, 2019. Available at: <https://www.fiscalia.gov.co/colombia/noticias/2-4-billones-de-pesos-fueron-blanqueados-en-operaciones-ficticias-de-compra-y-venta-de-oro/>

Many of these cases appear to be out of the same playbook. Corporate structures are manipulated in order to receive illicit funds, which are then laundered through purportedly legitimate business activities and reinvested into the economy. If these methods are being used repeatedly, as it seems they are, it bears the question: what are the legal and institutional loopholes in Colombia that allow corporate structures to be manipulated for illicit purposes?

Country Context

There are over 2,500,000 million licensed businesspersons in Colombia. This includes 1 one million legal persons (companies) and 1.5 million natural persons (entrepreneurs).⁴⁸ Data from the Bogota Chamber of Commerce provide additional insights into the breakdown of companies. As of 2018, the largest single category was "natural persons," or individuals, representing 76 percent of all companies. Excluding natural persons, the next most common corporate structure is the Sociedad por Acciones Simplificada, SAS (85 percent), followed by the Sociedad Limitada (seven percent) and the Sociedad Anónima⁴⁹ two percent).⁵⁰

It is also important to note that Colombia has high rates of economic informality, and many companies are not registered. According to a 2018 study, 58 percent of overall businesses and 84 percent of microenterprises are informal.⁵¹ In addition, not all companies created in Colombia have employees. Currently, 99.6 percent of new company registrations are microenterprises, and the remaining three percent are small enterprises.⁵² Moreover, only 48.9 percent created at least one job.⁵³

⁴⁸According to date from the Registro Único Empresarial y Social (RUES). Available at: <http://www.rues.org.co/RM>

⁴⁹Cámara de Comercio de Bogotá. Online database. Available at: https://sico.ccb.org.co/Sico/Paginas/frm_SolicitudInfo.aspx

⁵⁰Cámara de Comercio de Bogotá. Online database. Available at: https://sico.ccb.org.co/Sico/Paginas/frm_SolicitudInfo.aspx

⁵¹Cristina Fernández, "Informalidad empresarial en Colombia," Fedesarrollo, Working Paper No. 76, 2018-11. Geographical scope included Colombia's 24 largest cities. The definition of informality that was used includes 1) registering the business as a society or as a "natural person" and 2) maintaining formal accounting records. Available at:

https://www.repository.fedesarrollo.org.co/bitstream/handle/11445/3698/WP_2018_No_76.pdf?sequence=1&isAllowed=y

⁵²Colombian Federation of Chambers of Commerce, data cited is from January-September 2019. Available at:

http://www.confecamaras.org.co/phocadownload/2019/Cuadernos_Analisis_Economicos/Din%C3%A1mica%20de%20Creaci%C3%B3n%20de%20Empresas%20-%20Ene-Sep%202019.pdf

⁵³Colombian Federation of Chambers of Commerce, data cited is from January-September 2019. Available at:

http://www.confecamaras.org.co/phocadownload/2019/Cuadernos_Analisis_Economicos/Din%C3%A1mica%20de%20Creaci%C3%B3n%20de%20Empresas%20-%20Ene-Sep%202019.pdf

Colombian Legal Framework

The main legal framework for companies in Colombia is the Code of Commerce of 1971.⁵⁴ More recent legal developments include Law 1014 of 2006, “On Encouraging a Culture of Entrepreneurship” and Law 1258 of 2008 “Creating the Sociedad por Acciones Simplificada.” The SAS, Colombia’s newest corporate structure, “created a veritable revolution for the national economy and for the entrepreneur in particular, given its flexible capital structure and multiple benefits.”⁵⁶

Colombian law lays out nine corporate structures.⁵⁷ This report analyzes two of the most common types, Sociedad por Acciones Simplificada and Sociedad Limitada. The table below presents some of their main characteristics.

Table 3: Characteristics of Principal Corporate Structures in Colombia

| | Sociedad Por Acciones Simplificada (SAS): | Sociedad Limitada (SL): |
|------------------------|---|---|
| Capital requirements | None, but must be paid within two years. | None, but 100 percent capital must be paid up front, upon the creation of the SL. |
| Number of Shareholders | One or more. | Minimum of two partners, maximum of 25. |
| Shareholder liability | An SAS is a legal person. Shareholders are liable for the amount of capital they have invested. | An SL is a legal person. Shareholders are liable for the amount of capital they have invested. |
| Management | Flexible. A legal representative must be assigned. | Flexible. Management structure must be defined in its statutes. Decisions are made through consensus, and require majority approval. |
| Legal/Physical Persons | Can be constituted by one or by various persons, who can be natural persons or juridical persons, through a contract or a unilateral act recorded in a private document, is duly registered at the corresponding Chamber of Commerce. ⁵⁸ | Can be constituted by natural or juridical persons. ⁵⁹ |
| Registration process | Can be created through a private document or a public deed. The constitution document, even if private, must be authenticated. | Generally, requires a public record of shareholders and company information. However, for small companies with ten or fewer employees and earnings less than 500 times the monthly minimum wage, there is a simplified process. ⁶⁰ |

Source: “Sociedad por acciones simplificada S.A.S., Ley 1258 de 2008, Una Guía Práctica,” Superintendencia de Sociedades. Available at: http://www.cccucuta.org.co/uploads_descarga/desc_a0678e0c11c8250c8cf953fa49b77f35.pdf. Also see “Información general para creación de empresa,” Cámara de Comercio de Bogotá. Available at: <https://www.ccb.org.co/Cree-su-empresa/Pasos-para-crear-empresa/Constituya-su-empresa-como-persona-natural-persona-juridica-o-establecimiento-de-comercio>

⁵⁴<https://www.ccb.org.co/content/download/5915/86066/file/Codigo>

⁵⁵The code stipulates that any businessperson in Colombia is obligated to: 1) Register in the Mercantile Registry; 2) Present to the Mercantile Registry all acts, books and documents required by law; 3) Maintain regular accounting practices as required by law; 4) Maintain correspondence and support documents for their businesses or activities as required by law; and 5) Abstain from any acts of unfair competition. See <https://www.ccb.org.co/content/download/5915/86066/file/Codigo> Chapter 2 Article 19.

⁵⁶Isabel Cristina Sánchez Jiménez, “Sociedades mercantiles en Colombia, Breve historia, desarrollo y tendencias actuales. Una perspectiva desde el derecho comparado,” Universidad Católica de Colombia, 2017. Available at: <https://repository.ucatolica.edu.co/bitstream/10983/15051/1/SOCIEDADES%20MERCANTILES%20EN%20COLOMBIA.pdf>

⁵⁷These include: Empresa a título personal (persona natural), Sociedad Limitada, Empresa Unipersonal, Sociedad Anónima, Empresa Asociativa de Trabajo, Sociedad por Acciones Simplificada, Sociedad Colectiva, Sociedad Comandita Simple, and Sociedad Comandita por Acciones. See <https://www.ccb.org.co/Cree-su-empresa/Pasos-para-crear-empresa>

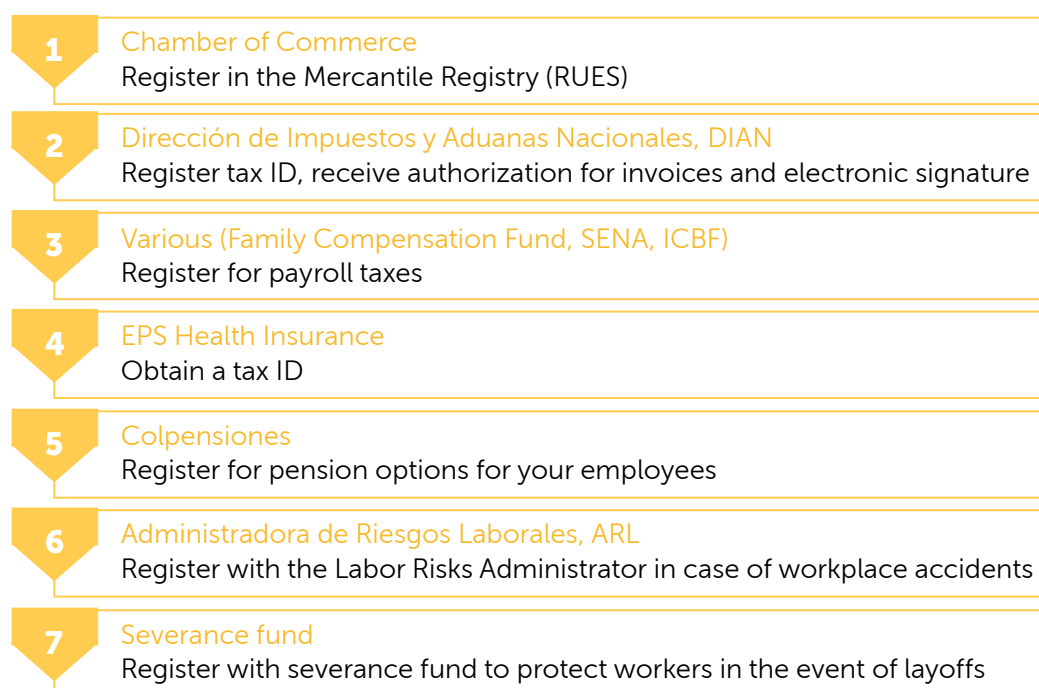
⁵⁸http://www.cccucuta.org.co/uploads_descarga/desc_a0678e0c11c8250c8cf953fa49b77f35.pdf

⁵⁹Chamber of Commerce of Bogotá, Online Chat with Virtual Business Advisor, December 17, 2019.

⁶⁰Ley 1014 del 2006. Available at: <http://www.camarasai.org/images/registro-mercantil/10LEY-1014-DE-2006.pdf>

The following diagram presents an overview of the general steps involved in creating a company in Colombia. There are slight differences by type of company and size. Generally, small companies with ten or fewer employees and earnings of less than 500 times the monthly minimum wage have a simplified process.⁶¹ Moreover, companies that do not have employees on payroll have a simplified process in terms of payroll tax and employee benefits. The process of corporate formation in Colombia typically takes ten days and costs 14.1 percent of per capita income.⁶²

Graphic 3: Steps to Creating and Registering a Corporate Entity in Colombia



Source: Global Financial Integrity's elaboration of process.

Vulnerabilities in the Business Formation Process

Colombian law does have certain safeguards in place to protect against corporate structures being created and manipulated for illicit purposes. For example, during registration with the Mercantile Registry, a variety of information is collected regarding the entrepreneur, or the company in question. Moreover, information on registered businesses and businesspersons is publicly available on the Registro Unico Empresarial (RUES),⁶³ which provides a degree of transparency. In the case of certain types of companies, such as the Sociedad Limitada, a public record of shareholders and company information is generally required as well.

⁶¹ Ley 1014 del 2006. Available at: <http://www.camarasai.org/images/registro-mercantil/10LEY-1014-DE-2006.pdf>

⁶² "Economy Profile: Colombia," Doing Business 2020, The World Bank Group. Available at: <https://www.doingbusiness.org/content/dam/doingBusiness/country/c/colombia/COL.pdf>

⁶³ See <https://www.rues.org.co/>

Table 4: Information Required by the Mercantile Registry

| For a Businessperson (Individual Entrepreneur) | For a Business (Company) |
|---|---|
| <ul style="list-style-type: none"> • Name of the businessperson • ID documents • Nationality • Activity or type of business • Residence and home address • Place or places where their business is carried out on a permanent basis • Liquidity • Details of all real estate assets in possession • Amount of the investment in the mercantile activity • Name of the person who is authorized to administer the business and their faculties • Names of entities providing credit for operations • References from two already registered business persons | <ul style="list-style-type: none"> • Name of the business • Address • Primary activity • Name and address of the owner and factor (manager) • Whether its place of operation is owned by the owner, or by another person |

Source: The Code of Commerce of Colombia, Current Version. Available at: <https://www.ccb.org.co/content/download/5915/86066/file/Codigo>

In addition, the use of nominee shareholders and nominee directors is impeded due to the requirements of the Colombian Code of Commerce in Article 110.^{64 65} As is noted, “the concept of nominee shareholding and the distinction between legal and beneficial owner that exists in other jurisdictions, in particular common law jurisdictions, does not exist in Colombia,” because when “a person purports to hold property for the benefit of a third person, that third person would have no rights under Colombian law to claim the property.”⁶⁶

However, there are also important weaknesses to this system that can be exploited by illicit actors. These include the following vulnerabilities: the Chamber of Commerce as the de-facto supervisor of the Mercantile Registry, coordination between government agencies, foreign ownership, regulation of middlemen and weak or inconsistent information on beneficial ownership.

To start with, the entity charged with “managing” the Mercantile Registry – that is to say, interacting with businesses, providing information on registration, processing applications and posting and updating corporate information – is a consortium of local Chambers of Commerce. While the Chamber of Commerce assumes a quasi-governmental, quasi-regulatory role, it is essentially a private sector organization. In that sense, its regulatory and supervisory abilities are limited.

As Dr. Eduardo Cifuentes Munoz noted before the Constitutional Court of Colombia, “The Chambers of Commerce are not public entities. While they are nominally ‘entities of a legal nature’ created by government, what is clear is that they are comprised of businessmen who are registered in the Mercantile Registry (...) Aside from the one function of business registration, the remainder of the functions of the Chamber of Commerce, their organization, and their Directors, their sources of income, the nature of their workforce (...) leave no doubt as to their corporate, gremial and private nature.”⁶⁷ As such, the first step of the corporate formation process is essentially self-regulation by the private sector.

⁶⁴Mutual Evaluation Report of the Republic of Colombia, GAFILAT, November 2018. Available at: <http://www.fatf-gafi.org/media/fatf/documents/reports/mer-fsrb/GAFILAT-MER-Colombia.pdf> See pg 149.

⁶⁵The Code of Commerce of Colombia, Current Version. Available at <https://www.ccb.org.co/content/download/5915/86066/file/Codigo> See Article 110.

⁶⁶“Peer Review Report, Phase 2 Implementation of the Standard in Practice, Colombia,” Global Forum on Transparency and Exchange of Information for Tax Purposes,” OECD, October 2015. Available at: <http://www.eoi-tax.org/jurisdictions/CO#latest> Page 38.

⁶⁷Corte Constitucional de Colombia, Sentencia No. C-144/93. Available at: <https://www.corteconstitucional.gov.co/relatoria/1993/C-144-93.htm>



Moreover, there appear to be issues of quality control, as well as coordination with other agencies. To cite one example, the Colombian Customs and Tax Authority (DIAN) manages a list of known fake companies. The list serves as a warning to other businesses and authorities: any invoice presented from one of these fictitious companies will not be accepted by the Colombian tax authority. The list of fake companies is periodically updated; at the time of publication, it was last updated in September 2019 and had over 450 registries.

When compared to the Mercantile Registry, numerous companies that are known and documented to be fictitious by DIAN nonetheless appear registered in RUES as “Active” members in apparently good standing. This raises a number of red flags. It may point to lack of coordination between DIAN and RUES, RUES data not being updated and/or RUES not serving as an adequate screening process. RUES serves as the first point of information on Colombian businesses, and as such, failure to properly label businesses that are known to be fictitious is concerning.

In addition to these very serious concerns with the Mercantile Registry, the Colombian corporate formation process is vulnerable to unscrupulous “middlemen” or “gatekeepers.” For example, the Colombian Superintendent of Societies regulates only the largest of law firms, accountants, real estate agents and dealers in precious metals. According to Colombia’s most recent GAFILAT evaluation, “there are, on average, about 250,000 accountants licensed by the Central Board of Accountants as individuals. This Board is the licensing and professional oversight body that deals with disciplinary sanctions for professional violations only. Only nine firms meet the Supersociedades criteria for AML/CFT supervision.”⁶⁸ Similarly, “of the estimated 1,093 real estate firms (including construction firms), only about 28 real estate agents that are registered as legal entities will be subject to ... supervision.”⁶⁹

Lastly, Colombia’s corporate formation process does not adequately collect information on beneficial ownership. Public registries, such as the Mercantile Registry, or the public list of shareholders (for Sociedades Limitadas) do not necessarily list the true owner of the company, or the company shares. In the case of a Sociedad Limitada, its structure can be formed using another business as its shareholder.⁷⁰ Thus, the public registry of shareholders would list companies within companies, without necessarily providing pertinent information on their true owners. Lack of information on beneficial ownership can make it harder to detect, investigate and prosecute crimes, and constitutes an important loophole in Colombia’s corporate formation laws. Colombia’s recent passage of a beneficial ownership law is an important step; however, implementation of the registry is still a pending task.

Moreover, multiple and inconsistent definitions of beneficial ownership in Colombia can hinder enforcement efforts. A review across agencies documented at least five definitions in use, with differences between the Financial Superintendence,⁷¹ DIAN,⁷² the Superintendence of Societies⁷³ and the Superintendence of Health.⁷⁴ Some of these definitions stipulate that the beneficial owner must be a natural person (as opposed to a legal entity), whereas others do not. The definition of ownership ranges from “more than five percent ownership,” “the faculty or power of voting in the selection of directors or representatives, or of directing, orienting or controlling aforementioned vote,” “exerts control as per FATF,” “exerts final, effective control” and “possesses or controls.” While these definitions may be similar in spirit, their inconsistencies may make beneficial ownership information more difficult to implement and shared across government agencies.

As Colombia’s most recent GAFILAT Mutual Evaluation Report indicates, information sharing among agencies is in fact a challenge. The report notes that “cooperation is not working in a wholly adequate manner” and that “Colombian authorities are aware of the challenges.”⁷⁵ Coordination between DIAN and the Unidad de Información y Análisis Financiero, the Colombian financial intelligence unit, is one such example. “UAIF has access to a wide range of information sources and has the authority to request any information from reporting entities and other appropriate authorities regarding ML/TF, but additional efforts are needed to have access in a timely manner to information collected by the DIAN and from real estate agents, notaries, law firms, accounting firms and beneficial ownership information.”⁷⁶

⁶⁸ Mutual Evaluation Report of the Republic of Colombia, GAFILAT, November 2018. Available at: <http://www.fatf-gafi.org/media/fatf/documents/reports/mer-fsrb/GAFILAT-MER-Colombia.pdf>

⁶⁹ Mutual Evaluation Report of the Republic of Colombia, GAFILAT, November 2018. Available at: <http://www.fatf-gafi.org/media/fatf/documents/reports/mer-fsrb/GAFILAT-MER-Colombia.pdf>

⁷⁰ Chamber of Commerce of Bogota, Online Chat with Virtual Business Advisor, December 17, 2019.

⁷¹ See <https://www.superfinanciera.gov.co/inicio/circular-basica-juridica-ce---10083443> and <https://www.superfinanciera.gov.co/descargas/institucional/pubFile1037344/2019023686.docx> as well as <https://www.superfinanciera.gov.co/publicacion/10083580>

⁷² See <https://www.dian.gov.co/normatividad/Normatividad/Resoluci%C3%B3n%20000060%20de%2012-06-2015.pdf>

⁷³ See https://www.supersociedades.gov.co/delegatura_aec/normatividad/estudios_economicos_financieros/Paginas/normatividad_nacional.aspx and https://www.supersociedades.gov.co/delegatura_aec/informes_publicaciones/lavado_activos/Documents/EE-%20Preguntas%20frecuentes%20LA%20FT-%202017%20III%2002.pdf

⁷⁴ See <https://docs.supersalud.gov.co/PortalWeb/Juridica/CircularesExterna/circular%20externa%20009%20de%202016.pdf>

⁷⁵ Mutual Evaluation Report of the Republic of Colombia, GAFILAT, November 2018. Available at: <http://www.fatf-gafi.org/media/fatf/documents/reports/mer-fsrb/GAFILAT-MER-Colombia.pdf> See page 34.

⁷⁶ Mutual Evaluation Report of the Republic of Colombia, GAFILAT, November 2018. Available at: <http://www.fatf-gafi.org/media/fatf/documents/reports/mer-fsrb/GAFILAT-MER-Colombia.pdf> See page 36.

Despite attempts to collect relevant information on corporate structures, foreign ownership presents another vulnerability. According to Colombia's most recent Mutual Evaluation Report, "While basic information of legal persons is updated annually and accessible in the public registries and supervisors' databases, the authorities have difficulty obtaining accurate and up-to-date information on the beneficial ownership of complex corporate structures and when there is foreign ownership or control involved."⁷⁷

⁷⁷Mutual Evaluation Report of the Republic of Colombia, GAFILAT, November 2018. Available at: <http://www.fatf-gafi.org/media/fatf/documents/reports/mer-fsr/b/GAFILAT-MER-Colombia.pdf> See page 11.





ARGENTINA

In Argentina, much like in the other countries featured in this report, the movement of illicit money is not dependent on the use of anonymous companies as the vehicle of choice. Instead, a general review of money laundering and corruption cases shows that the creation of front entities,⁷⁸ failure to register business activities⁷⁹ and failure to disclose accurate financial statements/tax filings⁸⁰ appears to be the preferred method to obfuscate ownership and business purpose to move illicit money.

The primary aim of this report is to understand whether the strengthening of norms around corporate formation can adequately serve as a bulwark against abuse of these structures to launder ill-gotten assets. The effectiveness of these norms becomes especially problematic in cases where corruption is systemic and deeply woven into the fabric of governance, as in the case of Argentina.

Case study – Use of Front Entities in Argentina

In a 2018 case in Argentina, the owners of a brothel allegedly used a “network of societies and fronts to channel and hide the income from the sexual and economic exploitation of prostitutes.” Moreover, they reportedly used front men and failed to register activities and financial records, covering up money made through sexual exploitation by marking it in records as business activities, such as entrance fees, or revenue from drinks. Much of the money taken was in cash, making it harder to trace. The owners reportedly used the money for the purchase and sale of vehicles and real estate.

Sources:

<https://www.fiscales.gob.ar/criminalidad-economica/mar-del-plata-procesaron-a-los-duenos-del-prostibulo-madahos-por-lavado-de-activo>,
<https://www.cij.gov.ar/nota-30287-Procesan-a-diez-personas-por-lavado-de-dinero-proveniente-de-la-explotaci-n-de-un-local-nocturno-en-Mar-del-Plata.html>

What further compounds the problem is the volatility of the Argentine peso, which has historically been part of a vicious cycle of debt, default and unscrupulous behavior by international hedge funds known as “vulture funds” for the ways they have preyed on countries in distress. Over the past decades, the Argentine peso has been de-valued several times, and in the last two years the currency has lost two-thirds of its value.⁸¹ In addition to causing financial distress for the country’s residents, this lowers confidence in the banking and financial institutions of the country and in the peso itself. To protect against this, Argentina has a long history of hoarding US dollars outside of the financial system, which in turn has created a lucrative black market for the currency.⁸² Economic turmoil has also fueled widespread capital flight as another mechanism to protect against the volatility of the peso.⁸³

⁷⁸Frances Jenner, “Cristina Kirchner and her two children will go to trial in Los Sauces case,” Argentina Reports, October 3, 2018. Available at: <https://argentinareports.com/cristina-kirchner-and-her-two-children-will-go-to-trial-in-los-sauces-case/1853/>

⁷⁹“Argentina raids 71 banks and financial entities suspected of money laundering,” MercoPress, November 12, 2014. Available at: <https://en.mercopress.com/2014/11/12/argentina-raids-71-banks-and-financial-entities-suspected-of-money-laundering>

⁸⁰“Argentina raids 71 banks and financial entities suspected of money laundering,” MercoPress, November 12, 2014. Available at: <https://en.mercopress.com/2014/11/12/argentina-raids-71-banks-and-financial-entities-suspected-of-money-laundering>

⁸¹“Argentina’s Economic Crisis and Default,” Congressional Research Services,” Updated June 15, 2020. Available at: <https://fas.org/sgp/crs/row/IF10991.pdf>

⁸²Lulu García-Navarro, “Argentina’s Approach to Inflation: Ditch the Peso, Hoard US Dollars,” National Public Radio, Morning Edition, December 16, 2014. Available at:

<https://www.npr.org/sections/parallels/2014/12/16/370979773/argentinas-approach-to-inflation-ditch-the-peso-hoard-u-s-dollars>

⁸³<https://www.ft.com/content/f283db90-c8e1-11e9-af46-b09e8bfe60c0>

Therefore, the illicit nature of capital flight⁸⁴ out of Argentina is co-mingled with what is perceived as a legitimate need to safeguard savings and finances.

Argentina does not generally serve as a destination for illicit financial flows from outside the region. From a regulatory standpoint, Argentina has incrementally adopted stronger laws on beneficial ownership and increased due diligence on corporate formation. However, what underscores the global nature of illicit financial flows is how inter-connected the financial system truly is. Corrupt money from Argentina often end up in secrecy jurisdictions that are also global financial centers including the United States and Switzerland, as discussed in the case studies in breakout boxes.

Case study – The Juan Pablo “Pata” Medina Case

Juan Pablo Medina was Secretary General of the Construction Union of Argentina in La Plata. Along with his son and son-in-law, he allegedly engaged in extortion and money laundering. Starting in 2006, Medina reportedly extorted money for construction projects. As many as 60 public works have been stopped due to what has been called a mafia operation. Investigations recovered much of the money, 40 expensive vehicles, several aircrafts and more. Medina operated under a city union organization. He reportedly used extortion, bribery, as well as adding conditions to work contracts after they were signed to launder money. Using ties with food companies, he overcharged customers and used the money for profit. Details are sparse, as investigations have been slow or halted for various reasons.

Source: <https://www.elpais.com.uy/mundo/pata-medina-dirigente-detenido-habla-toda-argentina.html>

Corporate Formation Requirements

In Argentina, every type of legal entity requires the following basic information underlying the legal ownership of the entity to be provided:

- Name, age, marital status, nationality, profession, address, and ID number of the shareholders/members/partners.
- For non-share companies (i.e., sociedad de responsabilidad limitada, sociedad en comandita simple, sociedad colectiva or sociedad de capital e industria), any change of legal ownership must be reported to the Company Registry.
- There is no similar requirement for share-based companies (i.e., sociedad anónima or sociedad en comandita por acciones), but share-based companies are required to submit financial statements on an annual basis, evidencing the ownership structure.

Analyzing Corporate Formation Data

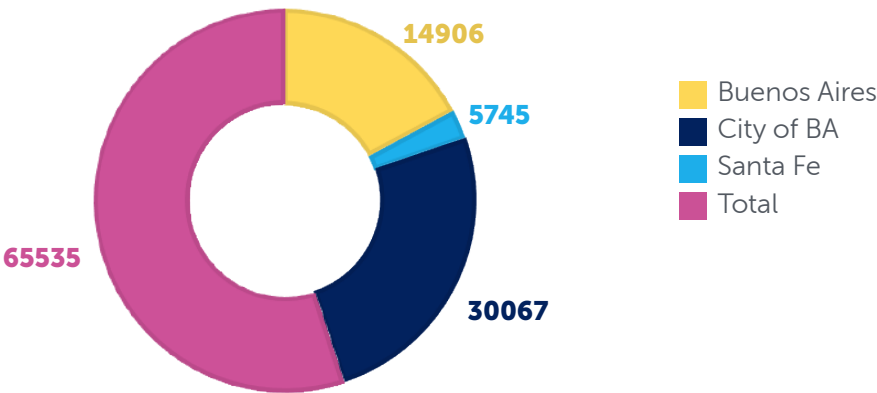
The company registry of Argentina is called the Inspección General de Justicia⁸⁵ and holds the necessary records on legal entity formation. Any entity failing to provide information, furnishing untrue information or otherwise failing to fulfil its duties under the law can be penalized. However, only the sociedad anónima is explicitly required to update every three years their respective information held in the company registry. Some of the information in the registry is accessible to the public and review of the data shows that there

⁸⁴See <https://www.investopedia.com/terms/c/capitalflight.asp>

⁸⁵See https://star.worldbank.org/sites/default/files/g20_bo_country_guide_argentina.pdf

are 22 different types of legal entities/legal arrangements registered in Argentina. According to most current data, this makes a total of 65,535 legal entities/arrangements registered. The overwhelming majority of registered entities are the sociedad anónimas and sociedad de responsabilidad limitadas.

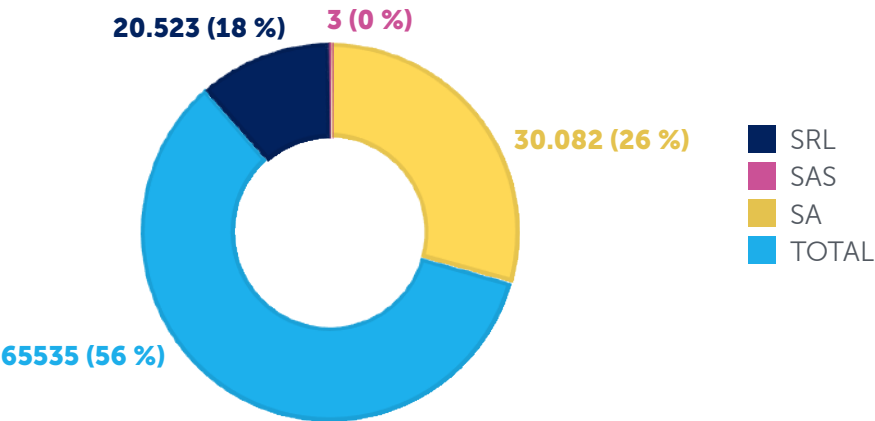
Types of Legal Entities Registered



Source: Global Financial Integrity (2020)

The majority of registered entities in Argentina are registered within the Autonomous City of Buenos Aires (26%), Buenos Aires (14%), and Santa Fe (5%). This information is useful because it can help both law enforcement authorities and researchers better understand domestically where the greatest proportion of risks lie and how to best allocate resources towards that. But at the same time, outliers can also raise alerts about the viability of setting up and registering a corporation outside these cities.

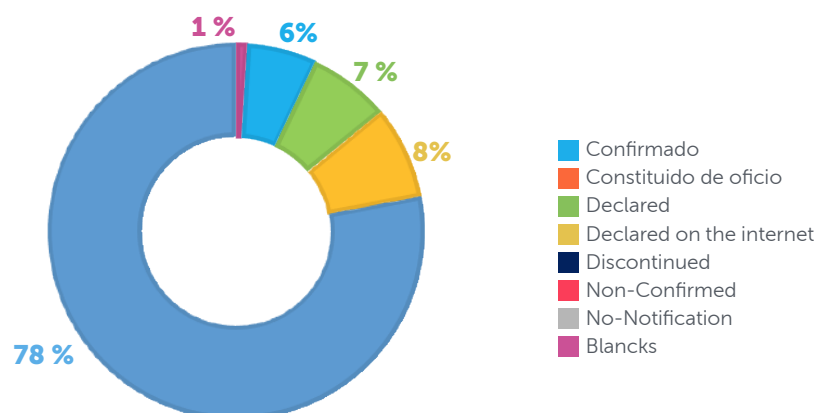
Place of Registration for Businesses



Source: Global Financial Integrity (2020)

The publicly accessible portions of the registry also break down the status of the business address registered entity. A breakdown of available data shows that 78% of available addresses on record have not been confirmed. What is also interesting is that there appears to be no preference between providing information via the internet (8%) or through a physical application (7%).

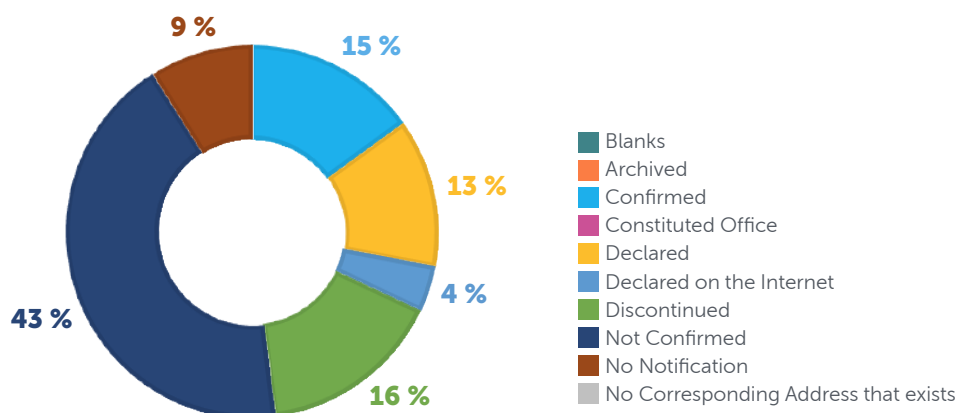
Status of Business Addresses provided to the Registry



Source: Global Financial Integrity (2020)

Similarly, a breakdown of the data on status of the place of registration of the legal entity shows that much like in the case of the address of the legal entity/arrangement, for 43% of businesses registered, this information remains unconfirmed. For 16% of the registered entities, the place of registration is either classified as either non-existent or discontinued.⁸⁶ What is also rather impressive about the way the registry records information is its ability to identify those certain addresses do not exist, which speaks to the checks within the system.

Status of the Place of Registration



Source: Global Financial Integrity (2020)

⁸⁶This is in contrast to other data sets which shows that only 6% of legal addresses for registered businesses in Argentina are classified as non-existent/discontinued.

With close to 80% of all registered businesses addresses unconfirmed, it is important to think of processes that could help facilitate and ensure that. In many ways, the data set provides a valuable snapshot of the corporate registration process and the Argentinian government should be commended for making the information public and easy to navigate. Nevertheless, what could provide added value is some data on beneficial ownership, shareholders, directors with all identifying information removed. What is additionally available is the date of creation of registered entities, the tax filing location information has been provided. It is positive to note that in every category of recorded information the ability of an entity to provide no information is few and far between. Data sets did reveal in nearly every category blank space where information should have been, but this represented less than 2% of the larger data set. Without further research in-person, it is difficult to appropriately establish the due diligence exercised when recording information on beneficial ownership data, director or shareholder information. Even keeping in mind privacy or confidentiality reasons, what would be beneficial to know from an accountability and governance standpoint is – a) whether beneficial ownership information was collected? b) was it verified and updated? c) is the beneficial owner a foreign person? d) was shareholder and director identification information collected and verified? Even having this information publicly without the full details creates greater accountability and an adequate system of checks and balances that can enhance the value of the positive reforms seen in Argentinian legislation and rulemaking.

Beneficial Ownership in Argentina

In April of 2020, the Argentinian government approved a new Regulation 4697 that would require beneficial ownership information to be registered for a wide range of legal entities including corporations, associations, partnerships and significantly investment funds. The new regulation does not include trusts within its purview. The inclusion of investments funds is of particular significance, as leaked documents in the US revealed that there are significant money laundering concerns in the private investment funds industry currently worth nearly US\$10 trillion. The new regulation issued by Argentina's tax authorities permits any foreign based entity that derives 50 percent of its passive income from interests, dividends, and royalties to limit its disclosures natural person that is not a true beneficial owner. It is also important to note that Argentina has a resolution on beneficial ownership, but no laws or centralized registries. Each agency - for instance the AFIP and the UIF - has its own registry. This in turn complicates the efficacy and usefulness of the beneficial ownership registry.





BRAZIL |

Country Context

Brazil, the largest and most populous country in South America, is also a regional economic powerhouse. By GDP, Brazil is the ninth largest economy in the world⁸⁷ and its financial system is considered one of the largest and most complex in Latin America.⁸⁸

The size, scale and influence of the Brazilian financial system, coupled with the country's vulnerabilities in terms of corruption, organized crime, drug trafficking, illicit pesticide trade and natural resource exploitation, all present heightened money laundering risks.

The country's last mutual evaluation by the Financial Action Task Force (FATF) was completed in 2010. However, (FATF) has since then issued six separate statements expressing their concern about "Brazil's continued failure to remedy the serious deficiencies" within its financial system to address AML/CFT threats.⁸⁹ Right on the back of this has been the exhaustive reporting and investigation of numerous corruption and money laundering scandals including the Odebrecht case,⁹⁰ Operation Car Wash ("Lava Jato")⁹¹ and numerous other instances of bribery and corruption. These cases have exposed the ease through which anonymous companies, front companies, and shell companies can operate within the country and threaten the integrity of Brazil's financial system and economy.⁹²

Types of Legal Entities

Set in this context, the process of registering legal entities and legal arrangements and the robustness of due diligence mechanisms is critical in preventing the movement of illicit capital in and out of the country.

Brazil has over 16,373,924 million registered companies.⁹³ It has ten different types of legal entities,⁹⁴ of which the most common are: Sociedade Anônima (SA) (Joint Stock Companies), Sociedade de Responsabilidade Limitada (SRL) (similar to LLCs in the US or UK), Sociedade Simples (Simple Partnerships), Sociedade Empresarial, (Entrepreneurial Activity Partnerships)⁹⁵ Empresa Individual de Responsabilidade Limitada (EIRELI). For the purposes of this chapter, we will be discussing Sociedade de Responsabilidade Limitada, Empresa Individual de Responsabilidade Limitada and Sociedade Anônima, some of the most common types.

⁸⁷"Gross Domestic Product Ranking Table," World Bank Data. Available at: <https://datacatalog.worldbank.org/dataset/gdp-ranking>

⁸⁸"Mutual Evaluation Report," Anti Money Laundering and Combatting the Financing of Terrorism: Federative Republic of Brazil," GAFISUD/FATF, June 25, 2010. Available at: <https://www.fatf-gafi.org/media/fatf/documents/reports/mer/MER%20Brazil%20full.pdf>, p.11

⁸⁹"FATF Statement on Brazil," FATF/GAFI, February 22, 2019. Available at:

<https://www.fatf-gafi.org/publications/methodsandtrends/documents/fatf-statement-brazil-feb-2019.html>

⁹⁰Daniel Gallas, "Brazil's Odebrecht Scandal Explained," BBC, April 17, 2019. Available at <https://www.bbc.com/news/business-39194395>

⁹¹Jonathan Watts, "Operation Car Wash: Is this the biggest corruption scandal in history?" The Guardian, June 1, 2017. Available at:

<https://www.theguardian.com/world/2017/jun/01/brazil-operation-car-wash-is-this-the-biggest-corruption-scandal-in-history>

⁹²Claire Felter and Rocio Cara Labrador, "Brazil's Corruption Fallout," Council on Foreign Relations, November 7, 2018. Available at:

<https://www.cfr.org/backgrounder/brazils-corruption-fallout>; See also Benjamin Fogel, "Brazil: Corruption as a Mode of Rule," NACLA, June 17, 2019.

Available at: <https://nacla.org/news/2019/06/17/brazil-corruption-mode-rule>

⁹³"Mapa das Empresas Brasileiras," data from Brazilian tax authority, May 2019. Available at:

<https://datasebraeindicadores.sebrae.com.br/resources/sites/data-sebrae/data-sebrae.html#/Empresas>

⁹⁴Update

⁹⁵2017 – this was modified to allow foreign legal entities to directly hold companies.

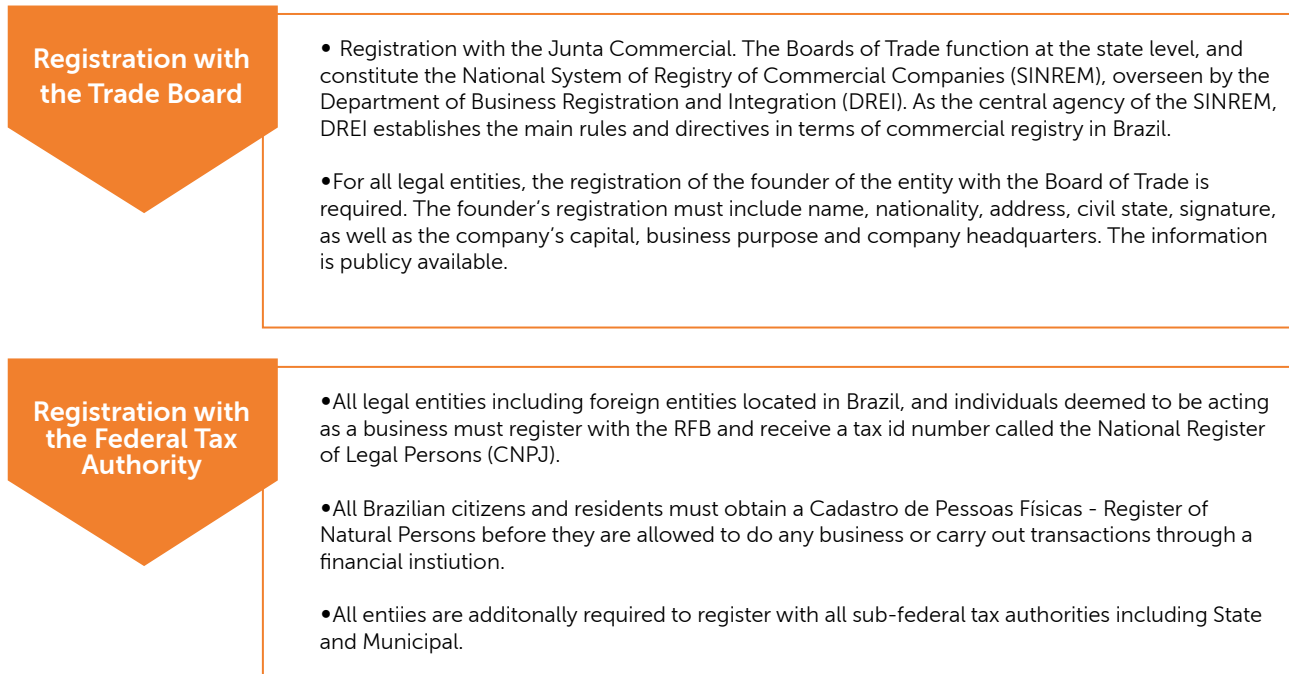
<https://mapajuridico.files.wordpress.com/2017/03/in-drei-38-2017.pdf> Pg 38 also see

<https://www.jornalcontabil.com.br/eireli-pode-ser-constituída-por-pessoa-jurídica/>

Process of Registration

Much like the US, Brazil adopts a federal structure for the registration of companies and consequently all companies are registered by the appropriate authority at the state level (Junta Commercial or Trade Board). Of all the different types of entities, SRLs and EIRELI are the easiest to register and maintain and the SA, the most complex. The emphasis with State registration and retention of documentation complicates the ability of this report to accurately discern the level of scrutiny and oversight in force across Brazil's 27 states.

Graphic 4: Process of Registration



Source: Global Financial Integrity's elaboration of process.

Process of Registration

The central company registry, Cadastro Nacional de Empresas (CNE), is not public. Even oversight and supervisory bodies, including law enforcement, can only access information within it after a formal cooperation agreement has been signed with the Federal Secretariat of Small Businesses, the agency responsible for coordinating the activities of the state-level trade boards.

Because of the decentralized nature in which registration information on legal entities are held, all records are held at the state level and by and large registration records can only be inspected in person. These records cannot be accessed online and for companies holding assets in another state, there is no immediately verifiable information.

Much like in the US, this decentralized structure of holding corporate formation records can lengthen the time and process through which law enforcement officials can access it.

Table 5: Characteristics of SA, SRL, and EIRELI

| | Sociedade Limitada | Sociedade Anonima | EIRELI |
|--|--|--|---|
| Capital requirements | None. | None. | US\$15,303. |
| Directors | Two. | | |
| Number of Shareholders | Two, can be NP or LP. ⁹⁶ | Two, can be NP or LP. | One and only a NP. After 2017, can be a LP. |
| Nominee Shareholders | Yes. | Yes. | Yes. |
| Management | Flexible. A legal representative must be assigned. | Flexible. Management structure must be defined in its statutes. Decisions are made through consensus and require majority approval. | NA |
| Owned by Foreign Individuals/ Entities | Yes. | Yes. | Yes. |
| Costs | US \$5,213 to establish the company and another US \$4,679 to register the company administration and acquire a registered office. | NA | NA |
| Registration process | Can be created through a private document or a public deed. The constitution document, even if private, must be authenticated. | Generally, requires a public record of shareholders and company information. However, for small companies with 10 or fewer employees and earnings less than 500 times the monthly minimum wage, there is a simplified process. ⁹⁷ | NA |
| Time taken for Process | 8-12 weeks. | NA | NA |

Source: Global Financial Integrity from a variety of sources (2020)

Sociedade de Responsabilidade Limitada (SRL) and Empresa Individual de Responsabilidade Limitada (EIRELI)

In general, the process of registration for an SRL requires two directors that can be of any nationality, proof of identity of shareholders and directors (copy of passports), registered address for the SRL to receive correspondence and a Brazilian resident appointed to act as executive director. In general, a “Limitada” has less legal formalities than a corporation and no financial statements must be published in official gazettes or major private newspapers. Also, “Limitadas” rarely reveal basic financial information, such as operating expenses or year-end profits. The length of time to successfully register an SRL can be anywhere between eight to 12 weeks.⁹⁸ This length of time would seemingly indicate the authorities are provided sufficient time and resources to carry out effective due diligence. Further digging into the process reveals that the information provided is merely collected and not always verified.

⁹⁶Natural Person and Legal Person

⁹⁷Ley 1014 del 2006. Available at: <http://www.camarasai.org/images/registro-mercantil/10LEY-1014-DE-2006.pdf>

⁹⁸<https://www.machadomeyer.com.br/en/recent-publications/publications/m-a-and-private-equity/legal-entity-may-own-an-eireli;>
[https://www.bizlatinhub.com/company-formation-brazil-sociedade-limitada-srl/;](https://www.bizlatinhub.com/company-formation-brazil-sociedade-limitada-srl/)

Previous analysis has shown examples where companies were permitted to complete filings without providing an address for correspondence, or the name of the company has been incorrectly spelled, the individual tax ID information given to persons has been incorrectly entered and names of countries and individuals are spelt in multiple permutations and combinations.⁹⁹ In short, the registration process suffers from many of the same problems seen in the UK public beneficial ownership register.¹⁰⁰

In the case of EIRELI, prior to 2017, the law only allowed individuals to set up these specialized types of entities. EIRELIs were introduced into the Brazilian legal system in 2011 with the aim of migrating the largely informal Brazilian business sector into a more formalized apparatus. The introduction of this was to permit ease of business registration and to reduce the number of fictitious partners that were listed on Sociedad registration records simply to meet the requirements of Brazilian law. EIRELIs promised lower tax rates and were to be classified as micro-enterprises. The only caveat was that minimum share capital would have to be 100 times the minimum wage in Brazil, which roughly works out to US\$15,303. In 2017,¹⁰¹ a new directive was issued that permitted legal entities to own EIRELIs. Unlike individual EIRELIs, there was no cap on the number of EIRELIs that could be owned by one legal entity. Furthermore, the law also permitted foreign ownership of EIRELIs.¹⁰² The requirement of the minimum share capital amounting to a little over US\$15,000 in some ways suggests a deterrent to the abuse of EIRELIs for “fly by night” money laundering operations.¹⁰³

However, what is critical in the initial share capital acting as a deterrent is whether the same amount can be recycled across 100 different EIRELIs all held by the same corporation, or if the amount simply being drawn down once the registration process was complete sufficed to form multiple EIRELIs.

Multiple sources indicate that Brazil does not recognize the concept of nominee shareholders and that anyone holding shares as a third party would be found to have committed fraud.¹⁰⁴ Yet a perusal of several company service providers and other consultancy firms specializing in market entry into Brazil openly advertise strawman shareholders and the use of nominee services. All this advertising continues unregulated and seemingly in contravention of the law. Furthermore, there do not appear to be records of any administrative, or punitive action taken by competent authorities against such businesses.

In the case of an SRL or EIRELI, only one shareholder needs to be identified and the shareholder can be of any nationality. The reality is that Brazilian authorities and the law implicitly permits¹⁰⁵ both a natural person and legal person to be a shareholder. Allowing this adds another layer of obfuscation and, especially in the case of foreign ownership, would make it virtually impossible for Brazilian authorities to identify individuals behind the corporate structure. Even if a natural person were to be identified and documents establishing the person’s identity were submitted, there is nothing stopping both an individual or a legal

https://www.transparency.org/whatwedo/publication/sao_paulo_does_corruption_live_next_door;

<https://www.doingbusiness.org/content/dam/doingBusiness/country/b/brazil/BRA.pdf>

⁹⁹https://www.transparency.org/whatwedo/publication/sao_paulo_does_corruption_live_next_door

¹⁰⁰Also, discuss role of lawyer and control in all of this.

¹⁰¹March 3, 2017, Item 1.2 of Annex V of Normative Instruction 38.2017 of the Department of Business Registration and Integration (DREI) amends the government’s interpretation of who can form an EIRELI. Starting on May 2, both individuals and companies can be shareholders of EIRELIs

¹⁰²There is some debate on this. Angelico Law, “EIRELI Law Allows Corporate Entities to Own Single-Member Companies,” April 18, 2017. Available at: <http://www.thebrazillawblog.com/eireli-allows-corporate-entities-single-member-companies/>

¹⁰³<https://www.bpc-partners.com/brazilian-taxes-what-you-need-to-know/business-creation-and-legal-obligations/>

¹⁰⁴“Brazil: Beneficial Ownership Transparency,” Transparency International.” Available at:

https://www.transparency.org/files/content/publication/2015_BOCountryReport_Brazil.pdf

¹⁰⁵Instrução Normativa, N 38, de 2 Março de 2017. Available at: <https://mapajuridico.files.wordpress.com/2017/03/in-drei-38-2017.pdf> See page 11.

entity or arrangement to from acting as a third party. Therefore, it appears very easy to create several layers of complex legal entities that can be spread across multiple jurisdictions, including tax havens, and continue to enter the Brazilian financial system with unfettered access.

Sociedade Anônima (SA)

The SAs are regulated by the Federal Law No. 6,404/76 ("Lei das SAs"). The Brazilian corporation is the form that most closely resembles US subchapter C corps. Corporations are allowed to issue different classes of shares. However, foreign shareholders must have legal representatives in Brazil. This type of entity is usually registered by large businesses' seeking to obtain funds from the general public. Much like the SRL the SA must have at least two shareholders, which may be individuals and/or legal entities (resident or non-resident). Corporations also have enhanced obligations in that they are required to file their financial statements with the local commercial registry and publish them in the Official Gazette, as well as in a major private newspaper. The complexity of the structure shows that SAs on their own do not present a high-risk vehicle to launder money, or to obfuscate ownership or source of income.

What is particularly interesting about Brazilian law is that, unlike the US, a unique address is required for each company. Multiple companies cannot be registered at the same address, nor can the address of the registered agent or company service provider be used. Additionally, Brazilian law does not accommodate for registered agents in the United States and other jurisdictions.

An analysis of the law suggests that while it is easier for a foreign entity to mask ownership information in comparison to a local entity/individual seeking to register a business, there have been investigative pieces done on the so-called "phantom companies" that exist in Brazil, with legal entities whose information on record does not match up with an actual verification of their documents.¹⁰⁶ There are also reports that Brazilians themselves move money out of the country into anonymous structures in the US.

Beneficial Ownership in Brazil

Brazil issued for the first time in 2016 requirements on Ultimate Beneficial Owners (UBOs) for foreign entities and Brazilian entities whose UBOs resided outside Brazil. However, the specific wording of the language created situations wherein there was no requirement to identify a UBO. To clarify this, the Cadastro Nacional da Pessoa Jurídica (CNPJ)¹⁰⁷ in 2017 issued a second directive which was meant to provide clarity, but ultimately was a source of much confusion and controversy with both regulators, the private sector and lawyers who were confused about what information was required to be filed and the absence of any clear definition of a UBO.

¹⁰⁶ See "Endereços falsos, sem funcionários nem equipamentos: são as empresas de fachada," *Jornal Nacional*, March 22, 2019. Available at: <https://g1.globo.com/jornal-nacional/noticia/2019/03/22/enderecos-falsos-sem-funcionarios-nem-equipamentos-sao-as-empresas-de-fachada.ghtml> ; See also <https://g1.globo.com/busca/?q=empresas+de+fachada>

¹⁰⁷ is an identification number issued to Brazilian companies by the Department of Federal Revenue of Brazil (in Portuguese, Secretaria da Receita Federal).

In December 2018, the CNPJ revoked all previous directives/regulations on the subject. It defines beneficial ownership to mean an individual that ultimately controls or has significant influence, where significant influence is defined as the individual owning directly or indirectly 25 percent of the stock or exercises 'preponderance' – that is decision-making power.¹⁰⁸

In addition, foreign entities not included in the UBO definition mentioned above — such as entities that own real estate, vehicles, vessels and aircraft and bank accounts in Brazil — are also required to disclose UBO information. The new regulations have only been in force for a year and companies were given till June 25, 2019 to ensure compliance with the directives.

As per the new regulations,¹⁰⁹ the following documents have to be provided in order to establish the identity of the UBO

- a copy of the articles of association, bylaws, constitution or equivalent (as applicable) or current company extract;
- a copy of the company director's legal ID or passport;
- a copy of the minutes of shareholders' meeting appointing the directors "or equivalent document" showing the powers held by the directors (if this is not available in the company's registration documents in the foreign country);
- a certified copy of the power of attorney (if the person is not appointed in the company's foreign registration documents) appointing a Brazilian individual who is a permanent resident with the powers to "manage the assets and rights of the legal entity" in Brazil to represent the company before the tax authorities and be served on behalf of the company;
- a certified copy of the ID of the person who holds the power of attorney as registered with the Federal Revenue Department; and
- a list of the company's shareholders and directors.

All documents from outside Brazil must be apostilled (or legalized at the Brazilian consulate or embassy, if the country where the documents are from not a member of the Hague Apostille Convention and translated by a sworn translator registered in Brazil. The documents must be filed in REDESIM a portal created by the federal government to attempt to streamline the registration process.

In July of 2019, the Brazilian Supreme Court passed their decision on a money laundering case concerning President Jair Bolsonaro's son. The Brazilian FIU – COAF¹¹⁰ have shared certain STRs¹¹¹ filed on Flavio Bolsonaro with the Prosecutor's office. The Supreme Court ruled in favor of Flavio and temporarily suspended all investigations in progress in Brazil that were based on confidential data shared by the COAF and the Federal Treasury without prior authorization from a court. This marked a huge departure from the established framework for investigation and information sharing as contained within the FATF 40 recommendations. It also effectively tied law enforcement's hands, because an analysis of any financial intelligence would have required a court order, thereby creating additional hurdles in what was already a very difficult investigative process.¹¹² This decision was short-lived, and the Supreme Court reversed this position in November 2019.

¹⁰⁸ "Beneficiários Finais para Entidades Nacionais ou Domiciliadas no Exterior," Receita Federal. Available at <http://receita.economia.gov.br/orientacao/tributaria/cadastros/cadastro-nacional-de-pessoas-juridicas-cnpj/beneficiarios-finais-para-entidades-do-miciliadas-no-exterior>

¹⁰⁹ Laws of Brazil, "Updated: Disclosure of Ultimate Beneficiaries to the Brazilian Federal Revenue Department," January 4, 2019. Available at: <https://lawsofbrazil.com/2019/01/04/disclosure-of-ultimate-beneficiary-information-to-the-brazilian-federal-revenue-department/>

¹¹⁰ Council for Financial Activities Control

¹¹¹ Suspicious Transaction Reports

¹¹² Maíra Martini, "Brazil's Supreme Court Halts Anti-Money Laundering Investigations," Voice For Transparency, July 23, 2019. Available at: <https://voices.transparency.org/the-role-of-financial-intelligence-units-and-the-fight-against-corruption-in-brazil-e745f1c8e749>



CHILE |

Chile presents a relatively strong institutional framework and lower risks for organized crime, drug trafficking and terrorism financing. The process for corporate formation is quite robust, with certain safeguards in place to protect against abuse. However, vulnerabilities can nonetheless be detected. Recent case studies from Chile show that illicit actors have found ways to use and abuse corporate structures, despite existing safeguards.

Chile's most recent Mutual Evaluation Report from GAFILAT, a regional body of the Financial Action Task Force, notes that corporate structures can be used as vehicles for financial crimes. According to the report, while mechanisms are varied, "crimes of public corruption or economic crimes in general, have been observed to use companies, whether they be functioning or not, and whether they be fronts or simply paper companies (...) Money laundering from illicit drug trafficking shares some of these typologies, of which the following merit special note: the use of front men (registering property in the name of third parties) and paper societies," among others.¹¹³

Chilean authorities from the Unidad de Análisis Financiero (UAF), the financial intelligence unit, have differentiated among various types of corporate vehicles that can be used for illicit activities. Among these categories are "Paper Societies," "Façade Societies" and "Screen Societies." They define "Paper Societies" as those that do not physically exist, nor carry out their declared business objective, and which are used by launderers to justify illicit inflows of funds. "Façade Societies," on the other hand, are those that "do have physical presence, but are dedicated to activities other than those that they have registered under, used by launderers to inject illicit funds and give them the appearance of legality." Finally, "Screen Societies" are those that are legally constituted, with physical presence and that carry out legitimate business functions as declared on their paperwork, but are used by launderers who mix illicit funds in with legitimate business earnings.¹¹⁴ According to analysis from the Chilean UAF, the presence of "Paper Societies," "Façade Societies" and/or "Screen Societies" were found in 63 percent of money laundering cases in the country from 2007-2017.¹¹⁵ In fact, among recent cases, 37.7 percent involved "Façade Societies," 17.0 percent involved "Screen Societies" and 9.4 percent involved "Paper Societies."¹¹⁶

¹¹³ Informe de evaluación mutual, Anti lavado de activos y contra el financiamiento del terrorismo (3ra ronda), GAFISUD, 2010. Available at: <http://gafilat.org/index.php/en/biblioteca-virtual/miembros/chile/evaluaciones-mutuas-3/90-chile-3ra-ronda-2010> Own translation.

¹¹⁴ Angela Toso Milos, Professor of Corporate Law, Pontificia Universidad Catolica de Valparaiso, Chile, August 2019. Available at: https://scielo.conicyt.cl/scielo.php?pid=S0718-00122019000200299&script=sci_arttext

¹¹⁵ Angela Toso Milos, Professor of Corporate Law, Pontificia Universidad Catolica de Valparaiso, Chile, August 2019. Available at: https://scielo.conicyt.cl/scielo.php?pid=S0718-00122019000200299&script=sci_arttext

¹¹⁶ "Evaluación Nacional de Riesgos de Lavado de Activos y Financiamiento del Terrorismo," Unidad de Análisis Financiero, Gobierno de Chile, 2017. See Pg 24.



The Vilches Case

In 2016, Chilean authorities detected and successfully prosecuted one such case. Harold Vilches, a 23-year-old Chilean man with powerful connections to a family jewelry business, as well as the Pentecostal Church, was convicted of illicit association, contraband, trade misinvoicing and asset laundering. Vilches brought precious metals of questionable origin into Chile, laundered them through a network of shell companies and then exported them to the United Arab Emirates and the United States. According to the Chilean Attorney General's Office, Vilches operated through "companies he created to give the appearance of legitimacy to his business, presenting, for each export shipment, documentation that was patently false." A series of complex corporate structures in Miami and Texas, created by business partners, further obscured the scheme. It is important to note that the primary method of storing, moving and laundering funds was through corporate structures: "of all the money collected by Harold Vilches in his transnational operations, there is no trace. In Chile, at least, there is not a single property or bank account under his name." Through this case, it is estimated that Chile lost 14.5 billion Chilean pesos (roughly US\$22.6 million) in tax revenue.

Sources: "Corte de Apelaciones confirma multimillonaria multa contra líder de banda que exportaba oro de forma ilegal," El Mercurio, February 22, 2018.

Available at:

<https://www.emol.com/noticias/Nacional/2018/02/22/896215/Corte-de-Apelaciones-confirma-multimillonaria-multa-contra-lider-de-banda-que-exportaba-oro-de-forma-ilegal.html> . "La trama oculta del mayor contrabando de oro detectado en Chile," El Centro de Investigación Periodística (CIPER) de Chile, August 19, 2016. Available at: <https://ciperchile.cl/2016/08/19/la-trama-oculta-del-mayor-contrabando-de-oro-detectado-en-chile/> . "Fiscalía destaca condena por Asociación Ilícita en caso de Contrabando de Oro," Ministerio Público de Chile, February 2, 2018. Available at: <http://www.fiscaliadechile.cl/Fiscalia/noticiaPdf?noticiald=14166>

While such cases are not common in Chile, they do call into question the present process for creating companies. What registration steps would illicit actors such as Vilches have had to follow? Are these steps adequate, with safeguards protecting against the misuse of corporate structures for illicit financial flows? How can Chile balance the needs of legitimate entrepreneurs with the security risks posed by illicit actors?

Country Context

There are an estimated 1.1 million businesses in Chile, according to 2015 data from the Chilean tax authority.¹¹⁷ According to official data, in Chile 95 percent of companies can be classified as mini or small, four percent as medium, and one percent as large.¹¹⁸ With regards to categories of businesses, 49.1 percent are registered as natural persons, followed by 33.4 percent as Sociedades de Responsabilidad Limitada. Sociedades anónimas are only prevalent among large businesses, according to reports by the Chilean Ministry of Economy. With regards to ownership, 97.7 percent of businesses are owned by solely Chilean nationals, and only 1.4 percent are exclusively owned by foreigners. However, among large businesses, 75 percent are owned solely by foreigners.¹¹⁹

¹¹⁷ "Estadísticas de empresas por región," Servicio de Impuestos Internos (SII). Available at: http://www.sii.cl/estadisticas/empresas_region.htm

¹¹⁸ "En Chile se crearon 132 mil empresas en 2018, según el Gobierno," El Economista, January 11, 2019. Available at: <https://www.eleconomistaamerica.cl/economia-eAm-chile/noticias/9629353/01/19/En-Chile-se-crearon-132000-empresas-en-2018-segun-el-Gobierno.html>

¹¹⁹ "Informe de resultados: Empresas en Chile: Cuarta Encuesta Longitudinal de Empresas," Ministerio de Economía, Fomento y Turismo, August 2017. Available at: <https://www.economia.gob.cl/wp-content/uploads/2017/03/Bolet%C3%ADn-empresas-en-Chile-ELE4.pdf>



Chilean Legal Framework

The main legal framework for companies in Chile is the Code of Commerce of 1865, last amended in 2014.¹²⁰ Beyond the Code of Commerce, there have been several important additions and updates to Chilean corporate law. Law N° 18.046 addresses Anonymous Societies, while Law N° 3.918 of 1923, last modified in 1997, establishes guidelines for creating Limited Responsibility Societies. Law No. 20.659 of 2013 simplifies the creation of societies, most notably through the Advanced Electronic Signature.¹²¹

There are five main types of companies in Chile:¹²²

- Empresa a título personal (persona natural)
- Empresa individual de responsabilidad limitada (EIRL)
- Sociedad por acciones (SpA)
- Sociedad de Responsabilidad Limitada (SRL or LTDA)
- Sociedad Anónima (SA)

¹²⁰"Código de Comercio – Última Versión," Biblioteca del Congreso Nacional de Chile (BCN). Available at: <https://www.leychile.cl/Navegar?idNorma=1048718>

¹²¹"Código de Comercio – Última Versión," Biblioteca del Congreso Nacional de Chile (BCN). Available at: <https://www.leychile.cl/Navegar?idNorma=1048718>

¹²²"La Sociedad por Acciones o SpA, Características y Requisitos," De Negocios Chile. Available at: <https://denegocios.cl/caracteristicas-spa-sociedad-por-acciones/>

This report analyzes two of the most common types of companies in Chile, the Sociedades de Responsabilidad Limitada and the Sociedades Anónimas.

Table 6: Characteristics of Principal Corporate Structures in Chile

| | Sociedades de Responsabilidad Limitada (SRL) | Sociedades Anónimas (SA) |
|------------------------|--|--|
| Capital requirements | Flexible, but the capital contribution of each shareholder must be clearly stated upon registration. | Flexible, but the capital must be registered in the Articles of Incorporation and can only be modified through a change in its Statutes. |
| Number of Shareholders | Must have between two and 50 partners. Partnership is fixed: no additional owners or investors can be added later, and shares cannot be transferred easily. For this reason, owners are generally linked through family or personal relationships. | At least two. New partners can be added quite easily. The Board must generally have 5 members for an Open SA, and three for a closed SA. |
| Shareholder liability | Constitutes a juridical person, managed by shareholders who are responsible only for what they have contributed in capital. | Constitutes a juridical person, managed by shareholders who are responsible only for the number of shares they possess. |
| Management | Flexible. Can be managed by one or multiple partners, or through an administrator who they designate. Not required to create a Board of Directors. | Must be managed through a Board of Directors elected by the shareholders. Decisions must be approved by the majority. |
| Legal/Physical Persons | Formed by physical or legal persons. ¹²³ Owners must be of Chilean nationality or possess Chilean residency. Must be adults. | Formed by physical or legal persons who act as shareholders. ¹²⁴ Shareholder participation can be managed by third parties, and shares can be easily sold or transferred. |
| Registration process | Formed, continued and demonstrated through a written public declaration. | Formed, continued and demonstrated through a written public declaration. Can be created as open or closed. ¹²⁵ |

Sources: "Sociedad de Responsabilidad Limitada," DeNegocios. Available at: <https://denegocios.cl/caracteristicas-y-requisitos-para-formar-o-crear-una-srl/> ; "Ley 3918 de 1923 en su Última Versión," Ministerio de Hacienda de Chile. Available at: <https://www.leychile.cl/N?i=243496f=1997-04-11&p=> ; and "Ley N. 18.046 Sobre Sociedades Anónimas. Available at: https://www.svs.cl/portal/principal/605/articles-808_doc_pdf.pdf

Registering a Company in Chile

The process for registering a company in Chile involves a relatively small number of steps and institutions, especially compared to other countries in Latin America. However, the information required at each step is fairly robust and occurs within a strong institutional context. According to some estimates, registering a company in Chile takes four days and costs 2.7 percent relative to per capita income.¹²⁶

¹²³ "Peer Review Report, Phase 2, Implementation of the Standard in Practice, Chile," Global Forum on Transparency and Exchange of Information for Tax Purposes, OECD, 2014. Available at: <http://www.eoi-tax.org/jurisdictions/CL#latest>

¹²⁴ "Tipos de Empresa en Chile," Constituyendo.cl. Available at: <https://constituyendo.cl/tipos-de-empresa-en-chile/>

¹²⁵ Open SA report their actions to the Registro de Valores, either voluntarily or as required by law. Special SA are those indicated by Title XIII of Law 3918, and include societies that work with mutual funds, stock markets, and other financial instruments. Closed SA are those that are neither Open nor Special. It is important to note that Open and Special SA are regulated under the Superintendencia de Stocks and Securities (Superintendencia de Valores y Seguros).

¹²⁶ "Economy Profile: Chile," Doing Business 2020, The World Bank Group. Available at: <https://www.doingbusiness.org/content/dam/doingBusiness/country/c/chile/CHL.pdf>

The entities involved in this process include:

- The Registro de Empresas y Sociedades (Company Registry)
- The Internal Revenue Service
- The Municipal Authority
- The Workplace Safety Authority

In 2013, Chile launched an electronic registration system for business creation. Today, the electronic registration is the most common method for incorporating new companies. Of the businesses created in 2018, for example, 77.2 percent were created through the Sistema de Registro de Empresas y Sociedades (RES), also known as “Tu empresa en un día” (Your company in a day), while the remaining 22.8 percent were created through the Official Gazette.

The process is outlined in general terms in the following graphic :

Graphic 5: Steps to Creating and Registering a Corporate Entity in Chile



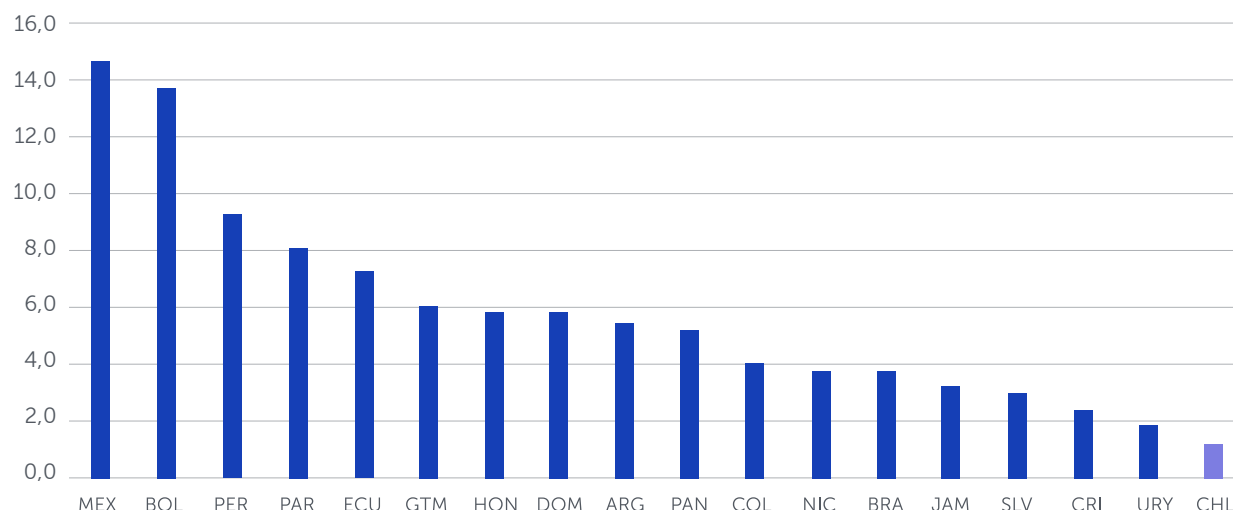
Source : Authors' own elaboration.

Vulnerabilities in the Business Formation Process

As mentioned, the process for registering a company in Chile involves a relatively small number of steps and institutions. However, the information required at each step is quite robust, as is the institutional context.

An important aspect to consider in the Chilean case is the relatively low vulnerability of this process to corruption, especially when compared to other Latin American and Caribbean countries. This is not to say that corruption never occurs, but rather that Chileans report lower levels of corruption than most of their neighboring countries, as the following graphic indicates. This makes the business registration process much more reliable. In the 2019 corruption Perceptions Index, Chile was ranked better in terms of lower levels of corruption compared to the other target countries in this report Brazil, Argentina, Colombia and Mexico.

Chart X: Citizen Experience of Bribery by Public Official, 2018-2019 (Percentage of Respondents)



Source: Latin American Public Opinion Project (LAPOP), 2018-2019. Response to the question: "In the last twelve months, did any government employee ask you for a bribe?". See https://www.vanderbilt.edu/lapop/ab2018/Statistical_Compndium_2018-19_W_10.22.19.pdf

The Chilean business formation process also requires a certain level of detail in the information collected. For example, to form a Sociedad Anónima, a public written declaration must contain:¹²⁷

- The name, profession or occupation, the domicile and domicile of its shareholders, and its tax ID or ID document, if they have them;
- The name and domicile of the society;
- An expression of the specific objectives of the society;
- The duration of the society, which may be indefinite. If nothing is specified, it shall be interpreted as being indefinite;
- The capital that the society possesses, the number of shares that it is divided into, including whether the shares have nominal value or not;
- The methods and timeframe for shareholder payments;
- The indication and value of any non-cash contributions.

Information on corporate structures is maintained by the Chilean tax authority, "by virtue of the mandatory declaration of creation of these entities, and annual declarations they make. In addition, the Commercial Registers and Legal Archives of public notaries also contain ownership and identify information and are public records accessible to anyone."¹²⁸

Nominee shareholders do not exist under Chilean law.^{129 130} Moreover, persons managing third-party shares ("mandatos") must inform the Superintendence of Stocks and Securities (Superintendencia de Valores

¹²⁷https://www.svs.cl/portal/principal/605/articles-808_doc_.pdf.pdf

¹²⁸Peer Review Report, Phase 2, Implementation of the Standard in Practice, Chile," Global Forum on Transparency and Exchange of Information for Tax Purposes, OECD, 2014. Available at: <http://www.eoi-tax.org/jurisdictions/CL#latest> See pg 53.

¹²⁹Peer Review Report, Phase 2, Implementation of the Standard in Practice, Chile," Global Forum on Transparency and Exchange of Information for Tax Purposes, OECD, 2014. Available at: <http://www.eoi-tax.org/jurisdictions/CL#latest>

¹³⁰As per the Ley de Sociedades Anónimas, "The particular agreements between shareholders relating to the transfer of shares must be deposited with the company at the disposal of the other shareholders and interested third parties, and reference will be made to them in the Register of Shareholders. If this is not done, such agreements will be unenforceable to third parties." See https://www.svs.cl/portal/principal/605/articles-808_doc_.pdf.pdf See Title 2 See Title 2, Article 14.

y Seguros) of the identity of any aforementioned third party, indicate their first name, last name, ID number, last known place of residence, number of stocks, number of stocks by society, number of societies and all other available information that pertains to the individual shares and shareholders. This process occurs annually during the month of March. In the case of banks and financial institutions that may have shares belonging to someone under the name of a third party, this information will be declared to the Superintendence of Banks and Financial Institutions, rather than to the Superintendence of Stocks and Securities.¹³¹

For a foreign anonymous society to be constituted in Chile, its agent or representative must notarize, in the location where it will operate in Chile, in the official language of the country origin, and a version translated to Spanish, the following documents from the country where the society was constituted:¹³²

- An authenticated version of its current statutes;
- A general power of attorney to the agent that will be representing it in Chile;
- At statement indicating that it has reviewed and understands Chilean laws;
- The amount of assets that will be kept in-country in Chile for operations, and the date and method that this capital has entered into Chile;
- The address of its headquarters.

Throughout these processes and requirements, there are penalties for falsifications, errors and fraud.¹³³

All of the processes and requirements described above help to prevent the use of corporate structures for illicit use. Despite the strengths of the Chilean system, however, certain vulnerabilities emerge upon closer analysis. These include a) beneficial ownership, b) legal entities forming corporate structures and c) transferability of shares.

Since 2017, Chile has required that banks, financial institutions, representatives of foreign banks and businesses working in the financial sector to collect and report information on beneficial owners¹³⁴ for customers that are legal persons, or legal structures.¹³⁵ In the case of foreign clients, the reporting entity must collect and report information on the highest ranking Chilean national, who in turn has 45 days to present information on the foreign beneficial owner(s).¹³⁶ In the gold case previously cited, Harold Vilches was able to avoid linking his name to any Chilean bank account during his illicit activities during the period 2014-2016.¹³⁷

While this is a positive requirement, disclosure of beneficial ownership is not explicitly required during the Chilean business registration process, which constitutes an area of vulnerability. Moreover, though illicit financial flows often move through the banking system, they do not always do so.

¹³¹https://www.svs.cl/portal/principal/605/articles-808_doc_.pdf

¹³²https://www.svs.cl/portal/principal/605/articles-808_doc_.pdf

¹³³https://www.svs.cl/portal/principal/605/articles-808_doc_.pdf

¹³⁴Chile defines beneficial ownership as "the natural person or persons who ultimately possesses, directly or indirectly, and through companies or other mechanisms, a participation equal to or greater than 10% of the capital or the rights to vote within a legal entity or a determined legal structure." It also notes that beneficial ownership includes "the natural person or persons who, regardless of whether they directly or indirectly possess shares of less than 10% of the capital, or regardless of whether they have voting rights in the legal entity or legal structure, throughout companies or other mechanisms, exert the final control in decision making regarding the legal entity or legal structure." See <https://www.uaf.cl/legislacion/beneficiario.aspx>

¹³⁵Circular UAF N. 57/2017, Unidad de Análisis Financiero, Gobierno de Chile. Available at: <https://www.carey.cl/download/newsalert/circular-n57-uaf-beneficiario-final.pdf>

¹³⁶"Financial Analysis Unit issues General Instruction with additional obligations of Due Diligence and Know Your Customer Control," Carey Chile, July 13, 2018. Available at: <https://www.carey.cl/en/financial-analysis-unit-issues-a-new-mandatory-general-instruction-as-to-ultimate-beneficiary-and-mandatory-know-your-costumers-due-diligence/>

¹³⁷"La trama oculta del mayor contrabando de oro detectado en Chile," El Centro de Investigación Periodística (CIPER) de Chile, August 19, 2016. Available at: <https://ciperchile.cl/2016/08/19/la-trama-oculta-del-mayor-contrabando-de-oro-detectado-en-chile/>

Among those who are exempt from reporting required beneficial ownership information, under Chilean law, are: firms that transport and transfers value and money; administrative societies; the users of Free Trade Zones; casinos, gaming and racing establishments; casino permit holders; customs agents; auction houses; property brokers and real estate management companies; notaries, pension fund administrators; property registrars (“conservadores de bienes raíces”), and professional sports organizations.¹³⁸ According to some legal scholars, the most troubling omission is that of property registrars and notary publics, “who are typically involved in the constitution, modification and dissolution of societies, according to traditional registration mechanisms in Chile. They often have firsthand information to identify the Beneficial Owner, especially in the case of societies that are formed by natural persons. To have effective AML/CTF controls in place with regards to societies and beneficial ownership, notaries and property registrars are among those who should be included in its application.”¹³⁹ The omission is especially concerning given that notaries and property registrars were identified as the sectors most vulnerable to money laundering, according to Chile’s 2017 National Risk Assessment.¹⁴⁰

Second, under Chilean law, certain types of corporate structures can be formed out of other corporate structures.¹⁴¹ This is the case of a Chilean Sociedad Anónima, for example, which can be constituted by individual persons or by other legal entities, who act as shareholders.¹⁴² When a company is formed out of another company, or out of a series of companies, ownership gets murky, which raises the risk of abuse by illicit actors.

Lastly, the flexibility of transferring shares in certain types of Chilean corporate structures may present vulnerabilities. One risk is that companies may be created by a figurehead and then transferred to another individual, for example. According to Chile’s most recent National Risk Assessment, this mechanism was present in 67 percent of cases investigated from 2007-2015, though there are some indications that it has subsequently declined.¹⁴³

¹³⁸Angela Toso Milos, Professor of Corporate Law, Pontificia Universidad Católica de Valparaíso, Chile, August 2019. Available at: https://scielo.conicyt.cl/scielo.php?pid=S0718-00122019000200299&script=sci_arttext

¹³⁹Angela Toso Milos, Professor of Corporate Law, Pontificia Universidad Católica de Valparaíso, Chile, August 2019. Available at: https://scielo.conicyt.cl/scielo.php?pid=S0718-00122019000200299&script=sci_arttext

¹⁴⁰Problems with notaries appear in 84.9% of cases from 2007-2015, while issues with property registrars appeared in 64.2% of cases. “Evaluación Nacional de Riesgos de Lavado de Activos y Financiamiento del Terrorismo,” Unidad de Análisis Financiero, Gobierno de Chile, 2017. See Pg 24.

¹⁴¹The law itself mentions multiple times that the shareholders in a Sociedad Anónima can be individuals or other corporate structures. See http://www.oas.org/juridico/spanish/mesicic2_chl_anexo_26_sp.pdf, See Article 2, Item 2, for example.

¹⁴²“Tipos de Empresa en Chile,” Constituyendo.cl. Available at: <https://constituyendo.cl/tipos-de-empresa-en-chile/>

¹⁴³“Evaluación Nacional de Riesgos de Lavado de Activos y Financiamiento del Terrorismo,” Unidad de Análisis Financiero, Gobierno de Chile, 2017. See Pg 24-25.

CONCLUSION

While each country faces unique conditions and challenges, certain cross-cutting issues can be identified. The table below summarizes the primary weaknesses identified for each of the countries.

Table 7: Comparison Across Countries: Primary Weaknesses Identified

| | Mexico | Colombia | Argentina | Brazil | Chile |
|-------------------------------------|--|--|---|--|--|
| Verification | Verification of registration data | | Verification of registration data, particularly of addresses | Information provided is merely collected and not always verified | |
| Beneficial Ownership Implementation | Determination of beneficial ownership, particularly since legal representatives and third-parties have wide-ranging abilities. | Weak or inconsistent information on beneficial ownership | Among company registration data that is publicly available, beneficial ownership data is usually absent | Struggles with identifying a definition that is feasible to implement and beneficial ownership data absent from information registry | Beneficial ownership may be required for bank accounts, but not for corporate formation itself |
| Middlemen | Nominee shareholders | Regulation of middlemen | Use of Illegal nominees | Strawman shareholders and the use of nominee services | Transferability of shares |
| The Registry itself | Registry Information backlogs and updates | The Chamber of Commerce as the de-facto supervisor of the Registry | Registry Information backlogs and updates | Information is recorded at the State level, not always centralized and also requires in-person access in certain States. | |
| Coordination | Variation among state requirements | Coordination between government agencies | | Coordinate between government agencies and stove piping of intelligence | |
| Foreign entities | Foreign legal entities | Foreign ownership | | | |
| Other | Corruption | | Capital Control Restriction, Corruption, and Limited FIU resources | Corruption and legal entities cannot be criminally charged under Brazil's money laundering statute | Legal entities forming corporate structures |

Source: Global Financial Integrity (2020).

As the table above indicates, multiple countries struggle with issues such as verification of company registration information, effective implementation of beneficial ownership, and middlemen or front men.

In light of these challenges, it is recommended that the countries in question:

- Create secure, simplified business registration processes that prioritize quality of information over quantity of steps. Key information to collect includes the beneficial owner, the real place of business, and accurate contact information.
- Build verification steps into the business registration process. For example, as companies declare a place of business, verification can occur by checking the address on google maps or calling the listed phone number to make sure it is actually in use; false information on company registration applications should be referred to the Financial Intelligence Unit, much like a Suspicious Activity Report.
- Consider using “mystery shoppers” or other verification means to ensure that state and local government offices are implementing corporate formation rules and regulations in a consistent manner.
- Ensure that the quantity of information collected and verified is commensurate with the risk level of the corporate entity. Requiring numerous steps and excessive paperwork from small businesses will only serve to maintain the sharp divide between formal and informal economies. However, for those companies with foreign ownership, international trade transactions, or involvement in higher-risk sectors, a more in-depth approach is warranted.
- Given the risks surrounding corporate structure and money laundering, ensure that corporate registration is administered by the State itself, and not by private sector representatives.
- Involve a variety of government agencies in decisions surrounding corporate formation, including those tasked with promoting entrepreneurship as well as those responsible for safeguarding the financial and trade systems; striking an adequate balance between these two objectives is key.
- Ensure that some if not all of company registration information is publicly available online; access to such information will help the private sector know who it is doing business (and avoid bad actors).
- Engage with other governments, international organizations and civil society groups to share best practices as well as pain points; many of the current challenges affect multiple countries in the region, and the regional AML/CFT response can only be as strong as its weakest link.



GLOBAL FINANCIAL INTEGRITY

As Strong as the Weakest Link:

Company Registration and Money Laundering
Vulnerabilities in Latin America

By Lakshmi Kumar and Julia Yansura

Global Financial Integrity

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