



Financial Monitoring Unit (FMU)

## RED FLAG INDICATORS FOR MISUSE OF LEGAL PERSONS

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### RED FLAG INDICATORS FOR MISUSE OF LEGAL PERSONS

Under FATF's Recommendation 24, countries are required to take appropriate measures to prevent the misuse of legal persons for Money Laundering/Terrorism Financing. Further, Immediate Outcome-5 also states that an effective system should be in place with effective measures to prevent legal persons from being used for criminal purposes. In Pakistan, following are the different types of legal persons that can be formed under various laws:

1. **Companies** formed under the Companies Act 2017, namely:
  - Single Member Limited Companies
  - Private companies.
  - Public companies (also referred to as listed companies).
  - Public interest companies.
  - Public sector companies.
  - Companies limited by guarantee (s 2 (19)).
  - Foreign companies (registered under Part 12 of the Companies Act).
  - Associations (formed as charities and not for profit companies) under s 42.
2. **Limited Liability partnerships (LLPs)** formed under the Limited Liability Partnership Act 2017 and defined under than Act as having separate legal personality (Part 2, s 3), namely:
  - Domestic limited liability partnerships.
  - Foreign limited liability partnerships (registered under s 2(m) and Part 10).
3. **Cooperatives** formed under prevailing Cooperative Societies laws at provincial level. These entities have independent legal status as legal persons upon registration.
4. **Proprietorship Concerns** formed by an individual, which is required to be dully declared by the individuals in their tax returns and to be registered as a proprietorship concerns in their National Tax Number (NTN) Certificate.



## FINANCIAL MONITORING UNIT (FMU)

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5. **Association of Person** Section 80 of Income Tax Ordinance, 2001 defines association of persons which includes a firm, a Hindu undivided family, any artificial juridical person and any body of persons formed under a foreign law but does not include a company.

To identify a suspicion that could be indicative of Money Laundering (ML) or Terrorism Financing (TF), FMU has prepared the red flags indicators that are specially intended as an aid for the reporting entities. These red flags may appear suspicious on their own; however, it may be considered that a single red flag would not be a clear indicator of potential misuse of legal person for ML / TF activity. A combination of these red flags, in addition to analysis of overall financial activity, business profile may indicate that the legal person is being potentially misused for ML / TF activity.

### **Customer Behavior:**

1. When a legal person or its beneficial owner or any of its associate natural person or transaction is from a high risk jurisdiction in relation to which FATF has called for countermeasures or enhanced client due diligence measures or jurisdiction known to have inadequate measures to prevent money laundering and the financing of terrorism.
2. The legal person that is associated with terrorism activities or the legal person that has been declared proscribed.
3. When any associated natural person of the legal person is proscribed for terrorism / terrorism financing related activities.
4. The legal person which is suspected to be using forged, fraudulent, or false identity documents for due diligence and record keeping purposes.
5. The employee/ director/ signatory/ beneficial owner of the legal person is unusually concerned with the reporting threshold or AML /CFT policies.
6. Legal Person linked to negative/adverse news or crime (named in a news report on a crime committed or under Law Enforcement investigation/inquiry).
7. Legal Person or any of its associated natural person / entity found positive match while screening against UN Security Council Resolutions (UNSCRs).



## FINANCIAL MONITORING UNIT (FMU)

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8. The legal person attempts to establish business relationship but fails to provide adequate documentary proof regarding its beneficial ownership details up to the satisfaction level of Financial Institutions or DNFBPs.
9. The beneficial ownership of the legal person appears to be doubtful while establishing relationship.
10. The complex formation structure that does not commensurate with nature of business activities or where legal person fails to disclose actual beneficial owner.
11. Multiple Legal Persons have been registered at same address or having similar contact details without any plausible reason.
12. Multiple types of legal persons are established with similar name and with same beneficial ownership.
13. The legal person owned by foreign nationals or by group of companies registered at foreign jurisdiction and failed to meet the CDD/KYC requirements regarding disclosure of ultimate beneficial ownership.
14. Unable to establish relationship between the beneficial owner and authorized signatory of the company.
15. Use of influential names (government linked / high profile entities) where the link with the high-profile entity whose name has been used cannot be directly validated.
16. Legal Person is invoiced by organizations located at any offshore jurisdiction that does not have adequate money laundering laws and is known for highly secretive banking and corporate tax haven.
17. Company records consistently reflect sales at less than cost, thus putting the company into a loss position, but the company continues without reasonable explanation of the continued loss.
18. Company has a long period of inactivity following incorporation, followed by a sudden and unexplained increase in financial activities.
19. Company is registered at an address that is also listed against numerous other companies or legal arrangements, indicating the use of mailbox service.



## FINANCIAL MONITORING UNIT (FMU)

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20. Company beneficial owners, shareholders or directors are also listed as beneficial owners, shareholders or directors in multiple other companies.

### **Transactional Patterns:**

1. Transactions that are not consistent with the usual business profile of the legal person:
  - a. Transactions that appear to be beyond means of the legal person based on its nature of business or declared business profile.
  - b. Transactions that appear to be more than the usual amount for a nature of business in which legal person is involved.
2. Frequent/multiple transaction involving entities with the same beneficial owner, which did not make economic sense.
3. The legal entity is engaged in a business that is not normally cash-intensive but appears to have substantial amounts of cash transactions.
4. Legal person deliberately avoids traditional banking service without legitimate reasons.
5. The transactions are structured to avoid reporting threshold requirements.
6. Large or frequent cash-based transactions, which do not commensurate with the stated business profile/ activities of the legal person.
7. Numerous transactions by a legal person, especially over a short period, such that the amount of each transaction is not substantial but the cumulative total of which is substantial, such transactional pattern do not commensurate with the legal person declared business profile.
8. Co-mingling of business and personal funds without any plausible reason.
9. Export / Import proceeds and other receipts and payments from/ to unrelated counterparties, which are not in-line with the legal person's business nature.
10. Round Tripping pattern of transactions that confuse the legitimate trading of business and apparently do not provide any economic benefit to the legal person.
11. High turnover of funds within a relatively short time without any plausible reason.
12. Unclear relationships between connected companies or transactional counterparties.



## FINANCIAL MONITORING UNIT (FMU)

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13. Deposit or attempt to deposit of funds via drafts / cheques issued in favor of different form of legal person but with the similar name.
14. Proceeds received from or payments sent to an unrelated foreign buyer against which no export shipments were sent, or no imports were made.
15. Proceeds received / sent against under or overvalued invoices of goods exported / imported.

**Disclaimer:**

*These red flags are developed for guidance purpose and may appear suspicious on their own; however, it may be considered that a single red flag would not be a clear indicator of potential ML / TF activity. However, a combination of these red flags, in addition to analysis of overall financial activity and client profile may indicate a potential ML / TF activity. While every effort has been made to ensure the accuracy and check all relevant references/ resources, errors and omissions are possible and are expected. Financial Monitoring Unit (FMU), its officers and its stakeholders are not responsible for any mistakes and/or misinterpretation.*