DAC Network on Governance

ANTI-CORRUPTION TASK TEAM MEETING

Room Document 6:
Concept Note: IFF Report 2016.

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1. UPDATING THE REPORT ‘Measuring OECD responses to IFF from developing countries’

Since the publication of the report ‘Measuring OECD responses to IFF from developing countries’, the benefits of comparing performance of OECD member states in IFF policy areas clear. Individual country reviews identify avenues for reform at the country level. However, country comparisons can add peer pressure and carry more weight. Cross country comparison can highlight inconsistencies between political commitments and actual implementation, turning the spotlight on a group of countries or a region in contrast to others. That is the reason why DCD proposes to build on the 2013 IFF report, ‘Measuring OECD responses to IFF from developing countries’, with a new report.

Keeping with DCD’s agenda for IFF work, after a report focusing on a developing region¹, attention should shift again to the performance of OECD countries to maintain the topic as a reform agenda for OECD countries. Secondly, a comparative report could also increase its comparability angle by looking at a second set of countries beyond the OECD group.

The objectives of this report are:

- To expand the understanding of how a larger number of countries perform on IFF, increasing the comparative effort;
- To delve deeper into specific policy areas in which OECD countries had weaker performance in 2013 identifying what has changed since the last OECD IFF report;
- To identify a number of areas in which data could be collected in OECD countries to build a picture of these countries’ capacity in areas relevant to the fight against financial crime.

2. REASONING FOR THIS STUDY

Alternatives for a report following the comparative effort of 2013 were examined. For example, the DCD team considered the option of conducting a similar review on the 5 policy areas studied in 2013. To conduct such a study, updated datasets of those used in 2013 are required for all OECD member states. However, some will not be available for the totality of OECD countries until much later in the decade (for example, the Financial Action Task Force’s peer review cycle for all OECD member states extends through 2020).

For this reason, this concept note proposes the approach mentioned in section 1 above:

- firstly, to look into a second set of countries in the policy areas studied in the 2013 report. It is proposed that this includes countries beyond OECD still to be defined (options include extending the analysis to G20 countries or another category of countries covering Brazil,

¹ The second IFF report, under preparation in 2015, studies the ‘other side’ of IFF: not focusing on where such flows end up, but on the processes that take place in developing countries and generate IFF. The object of that study is illicit trade activity, such as smuggling of counterfeit goods and drug trafficking among others. The developing region object of attention is West Africa. This delimitation of processes and regions is deliberate to make the study feasible and reflects the interests of members of the DAC (see concept note for the 2015 report for more detail).
Russia, China, Hong Kong, India, Singapore, Indonesia, Lebanon, United Arab Emirates, Mauritius, Saudi Arabia, for the reasons explained in section 3a).

- secondly, to look into one policy area in which OECD countries were assessed 2013 to provide a more in-depth analysis. It is proposed that the policy area is beneficial ownership\(^2\) (BO), for the reasons explored in section 3b below.

3. ISSUED COVERED IN THIS REPORT

This report will build on the 2013 IFF report, offering scrutiny of OECD member states and updating information wherever possible. The slow rate of change in the data does mean that there will also be some significant differences to the 2013 report. As a result this version will have two main sections. These can be summarised as:

- section one – comparative evidence on non-OECD countries that applies the 2013 approach to different actors;
- Section two – a focus on beneficial ownership as a major issues for OECD states;

Both would benefit from efforts to identify data to build a picture of these countries’ capacity in areas relevant to the fight against financial crime. The report will address each issue i) describing the problem and its scale, ii) outlining the development and governance impacts, iii) recommendations and action.

a. Comparative evidence on relevant NON-OECD countries in fighting IFF

This report would enrich the debate on fighting IFF by looking at a second group of countries or jurisdictions beyond OECD. These would be countries which opened up markets, increased cross border financial activity, created new opportunities for international trade and have become drivers as well as recipients of significant foreign direct and portfolio investment. Since the financial crisis, and regardless of the difference in performance or growth countries like the BRICS, for example, still responded for 45 per cent of global growth in 2007-2012 (Atale 2012). In 2014, transnational corporations from non-OECD economies were responsible for 39 per cent of global FDI outflows (UNCTAD 2014). Some non-OECD countries are also among the largest accumulators of foreign reserves: for example, China, Saudi Arabia, Brazil and India (Farrar and Ariff 2014, World Bank 2013).

As a result of their global interconnectedness and relevance to the world economy, interest in their governance practices has increased (Borodina and Shvyrykov, 2010). However, openness and integration have also increased their vulnerability (Perez et al 2012) and attraction to illicit activity, illustrated by the examples below. Vulnerability expressed through illicit activity taking place in these countries finding easier routes out for its revenue. Corruption scandals involving Brazilian and Chinese officials are two examples. A number of the senior public officials investigated in the Petrobrás, Brazil’s oil company, corruption scandal appears as owners of undeclared bank accounts in Switzerland while Chinese officials have been involved in money laundering charges abroad (Reuters 2015, WSJ 2015). Attraction to illicit activity, on the other side, is evidenced by heightened

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\(^2\) This concept note uses FATF definition of beneficial ownership: “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” (FATF, 2014).
concerns on the purchase of luxury property in, for example, UAE as a vehicle to evade taxes or to launder drug revenues (Threnwith 2013; Mathiason 2010). Other countries, like Singapore, appear to have become alternative channels for funds that would have been laundered in other countries now under more scrutiny (Hesse, 2013).

**Previous research.** No previous comparative research has been published so far showing how any group of non-OECD countries perform in IFF relevant policy areas. Data for such comparative review could come from individual country reviews, such as:

i. FATF peer reviews: most countries in the world are individually reviewed as members of FATF Style Regional Bodies (FSRB).

ii. OECD Working group on bribery reviews: in this case, only seven non-OECD countries are individually reviewed as part of this peer review process: Brazil, Argentina, Colombia, South Africa, Bulgaria, Latvia and Russia. This would reduce the number of non-OECD countries that could be subject to comparison.

iii. Global Forum on Exchange of Information for Tax Purposes peer reviews: A large number of non-OECD countries are members of the Global Forum, therefore subject to their reviews.

The benefit of extending comparative analysis through these countries is twofold:

- responding to the ‘water balloon effect’ common in criminal activity. The water balloon expression illustrates the process through which criminals move to another country or region where they can operate under less scrutiny and regulation as soon as the place where they are active is subject to increased scrutiny and repression. This report would extend monitoring and global attention to some of these new destinations.

- analysing such countries may have spill over effects to their respective regions given the regional ‘hub’ role that they play. Some of these countries are the economic drivers of regions and are able to shift regional trends – hence, pressure for reform in them have the potential to trigger change elsewhere.

**b. Beneficial ownership in OECD countries**

The report would extend the analysis on OECD countries by focusing on one of the policy areas that received attention in 2013: beneficial ownership. The topic of beneficial ownership has gained importance in the area of IFF as one policy in which progress can have positive effects in different areas. Knowing who owns or controls a legal person ultimately may be the key to identifying individual or commercial tax evaders, criminals trying to hide the proceeds of crime (including the instruments and the proceeds of corruption, for example the bribes and the luxury goods bought with them) and allowing citizens and firms to know who they are doing business with.

The demand for attention to BO has increased significantly since the global financial crisis: it has been explicitly mentioned in G20 communiques since 2012, including a requirement for G20 countries to draft action plans and report on how they address obscure ownership structures (G20 2012, G20 2013, G20a 2014). A set of principles guiding G20 countries in BO challenges was issued in 2014 (G20b 2014). In early 2015, the EU Parliament approved the 4th Anti-Money Laundering Directive that obliges for the first time EU member states to keep central registers of information on the ultimate beneficial owners of corporate and other legal entities, as well as trusts (EU 2015).
Moreover, as shown through the OECD report “Measuring OECD responses to IFF from developing countries”, BO is one of the areas in which OECD member states underperform (p.33, OECD 2014).

**Previous research.** The comparative performance of OECD countries in the area of BO has not been the topic of dedicated research per se (G8 countries and, more specifically, UK and its territories have been compared by some NGOs. The World Bank is preparing guides on BO to be used by G20 countries). Within the OECD, countries are individually monitored through:

a) FATF peer reviews (chapter 7 Legal persons and arrangements),
b) the Global Forum peer reviews (the new methodology of the Global Forum peer reviews, starting to be implemented in 2016 with first publications in 2017, will provide more detail on BO).

The issue of BO merits to be explored in more detail by the OECD Secretariat considering that the issue has not been highly profiled in existing peer review mechanisms. OECD would make an important global level contribution featuring the topic more prominently. A second argument is that some OECD countries have passed legislation on public registries of beneficial ownership (i.e. UK, Denmark and Norway). It would be interesting to see how having this information has helped in cases of prosecution of corruption or recovering tax evasion.

Conducting a survey with OECD countries on this topic would address some of the criticism received for the 2013 report, which suggested that data from peer review processes do not show all countries in the same moment in time. Therefore, those countries whose peer reviews were conducted recently fare better than those with older reviews. Even though a survey would present less in-depth analysis than a full per review and would be a country’s self-assessment, such exercise would allow to show a snapshot of the performance of all OECD countries in time.

**3. Analysis of Action by OECD states - Inclusion of proxy indicators in the area of IFF.** Relevant information on how OECD countries perform in a few key areas could show a picture of their capacities in this field. For example, annual enforcement data gathered by the OECD Working Group on Bribery (WGB) beyond their peer review process helps to understand how OECD countries are prepared to address some financial crimes (some of the information collected include number of individuals and entities sanctioned for foreign bribery, among other quantitative information). A survey could also be used to gather input and output-based data: for example, the size in budget or in number of staff of units investigating financial crimes. Although it is acknowledged that this type of data does not necessarily imply effective implementation (having a large financial crime investigating unit does not automatically translate in more activity in this area), knowing this would give a picture of the capacities in place in OECD countries.

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3 These results were achieved comparing past FATF peer reviews of OECD member states. It should be noted that the peer reviews for different countries were conducted in different years, therefore the picture shown for any given country may be more or less recent depending on when the country was subject to a FATF peer review process.

4 Global Witness and Christian Aid have published two documents (2013, 2014) comparing G8 countries plus Hong Kong and Singapore on their performance on BO and comparing UK and its dependencies and territories. The results were presented in a traffic light system (GW and Christian Aid 2013, GW and Christian Aid 2014).

4. TIMING

Data collection for this report would start in early 2016 and the publication would happen in early 2017.

5. DRAFT OUTLINE

a. Introduction: Expanding the scope and deepening analysis on IFF issues

   Item 1: Reasons for focusing on a deeper analysis of Beneficial Ownership in OECD countries

   Item 2: Why should we care about how countries beyond OECD perform in fighting IFF?

   Item 3: Global developments in AML, tax evasion (i.e. Automatic Exchange of Financial Account Information for Tax Purposes), bribery payments and ODA support in the IFF area since 2013

b. Beneficial ownership in OECD countries

   Item 1: Survey results: where have OECD countries reformed in BO since 2013

   Item 2: International developments regarding BO since 2013:
   - G8
   - G20
   - 2015 Fourth EU anti-money laundering directive
   - 2013 UK’s public company ownership registry
   - 2014 Denmark’s public company ownership registry
   - 2014 US FinCen proposed rules on due diligence
   - 2015 Norway’s legislation on public registry of company ownership

c. Fighting IFF in non-OECD countries: A comparative review of Brazil, Russia, China, Hong Kong (China), India, Singapore, Indonesia, Lebanon, United Arab Emirates, Mauritius, Saudi Arabia.

   Item 1: How do other countries fare in AML standards?

   Item 2: How do other countries fare in implementation of tax exchange of information agreements?

   Item 3: How to bring these countries into a global conversation about their domestic policies’ impact on other developing countries?

d. Policy implications

   Item 1: Donor community and advocacy on BO issues at home and in global fora

   Item 2: Engaging with peers: What leverage the donor community has on countries beyond OECD?

6. METHODOLOGY

The final report could use several different data collection mechanisms:
- a survey elaborated to collect information directly from authorities in OECD and non-OECD countries (a self-assessment);

- data produced by different OECD directorates (such as the enforcement data produced by the WGB, mentioned above);

- desk based review of relevant literature;

- commissioning of case studies.

7. AUDIENCE

The DAC donor community is the primary audience for this report. However, it will be relevant for authorities in the countries subject to attention as well as academia, civil society and think tanks working on the topic.
REFERENCES


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